Company Focus

6 November 2008 | 11 pages

Sun TV Network (SUTV.BO)

Upgrade to Buy: Regional Powerhouse, Reasonable Valuations

Change in opinion ☑
Rating change ☑
Target price change ☑
Estimate change ☑

- **Upgrade to Buy (1M), target price Rs185** — Post a strong Q2FY09 and price correction of ~65% YTD, we upgrade Sun TV Network (Sun) to Buy/Medium Risk. Sun TV offers a strong play on regional advertising with leverage to DTH.
- **Why we like Sun TV** — (a) Dominance in the South Indian market; (b) High profitability– ~69% EBITDA margins and ~27% RoE; (c) Leverage to DTH – we expect DTH revenues of Rs1.3b (which have very high margins) in FY10E; (d) Healthy balance sheet (net cash of ~Rs4b+); and (e) 18% EPS CAGR over FY08-FY11E trading at ~11.8x FY10E.
- **Strong 2Q, but moderate estimates to factor in slowing economy** — Ad revenues grew at a healthy 30% yoy. EBITDA margins were stable at ~75%; net profit increased 35% yoy. Cable subscription rebounded 20% qoq while DTH revenues should witness a sharp ramp-up 3Q onwards as billing to new operators starts. However, we lower our FY10/11 EPS est. by 7/12% to factor in the impact of a slowing economy on advertising spends. We model 18%, 15% & 12% advertising revenue growth in the rest of FY09, FY10 & FY11 respectively.
- **Value in-line with ZEEL** — Sun is better leveraged to ad-revenue growth due to its strong leadership position in Southern markets vis-à-vis ZEEL – the third most viewed GEC in its highly fragmented Hindi space. Sun and ZEEL are equally leveraged to pay-revenue from DTH penetration. We forecast similar EPS CAGRs over the next 3 years for ZEEL and Sun and value both at 15x FY10E EPS.
- **Risks** — Increasing competition may affect viewership ratings; impact of rising costs, which we expect should be compensated by DTH revenues.

Buy/Medium Risk	**1M**
from Hold/Medium Risk	
Price (06 Nov 08)	Rs146.50
Target price	Rs185.00
from Rs268.00	
Expected share price return	26.3%
Expected dividend yield	2.0%
Expected total return	**28.3%**
Market Cap	Rs57,733M
	US$1,220M

Price Performance (RIC: SUTV.BO, BB: SUNTV IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2007A	2,461	6.24	93.1	23.5	4.8	32.8	1.0
2008A	3,267	8.29	32.8	17.7	4.0	24.7	1.7
2009E	4,347	11.03	33.1	13.3	3.3	27.2	2.0
2010E	4,904	12.44	12.8	11.8	2.8	25.7	2.4
2011E	5,391	13.68	9.9	10.7	2.4	23.9	2.7

Source: Powered by dataCentral

Surendra Goyal, CFA[1]
+91-22-6631-9870
surendra.goyal@citi.com

Hitesh Shah, CFA[1]
+91-22-6631-9872
hitesh.b.shah@citi.com

Aditya Mathur[1]
aditya.mathur@citi.com

See Appendix A-1 for Analyst Certification and important disclosures.

[1]Citigroup Global Markets India Private Limited

Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	23.5	17.7	13.3	11.8	10.7
EV/EBITDA adjusted (x)	11.7	8.8	7.2	6.0	5.2
P/BV (x)	4.8	4.0	3.3	2.8	2.4
Dividend yield (%)	1.0	1.7	2.0	2.4	2.7
Per Share Data (Rs)					
EPS adjusted	6.24	8.29	11.03	12.44	13.68
EPS reported	6.24	8.29	11.03	12.44	13.68
BVPS	30.28	36.76	44.28	52.63	61.63
DPS	1.52	2.50	3.00	3.50	4.00
Profit & Loss (RsM)					
Net sales	6,780	8,699	10,598	12,347	13,834
Operating expenses	-3,256	-3,963	-4,872	-5,575	-6,326
EBIT	**3,524**	**4,736**	**5,726**	**6,773**	**7,508**
Net interest expense	-64	-159	-28	0	0
Non-operating/exceptionals	411	556	845	751	798
Pre-tax profit	**3,871**	**5,133**	**6,543**	**7,524**	**8,306**
Tax	-1,401	-2,015	-2,290	-2,633	-2,907
Extraord./Min.Int./Pref.div.	-8	148	94	13	-8
Reported net income	**2,461**	**3,267**	**4,347**	**4,904**	**5,391**
Adjusted earnings	2,461	3,267	4,347	4,904	5,391
Adjusted EBITDA	4,742	5,975	7,260	8,451	9,385
Growth Rates (%)					
Sales	110.6	28.3	21.8	16.5	12.0
EBIT adjusted	85.9	34.4	20.9	18.3	10.9
EBITDA adjusted	91.2	26.0	21.5	16.4	11.1
EPS adjusted	93.1	32.8	33.1	12.8	9.9
Cash Flow (RsM)					
Operating cash flow	**3,701**	**3,909**	**5,075**	**6,300**	**6,924**
Depreciation/amortization	1,218	1,239	1,534	1,678	1,877
Net working capital	100	-516	-712	-269	-352
Investing cash flow	**-2,873**	**-5,930**	**-2,712**	**-2,724**	**-3,066**
Capital expenditure	-2,945	-4,145	-2,697	-2,724	-3,066
Acquisitions/disposals	71	-1,785	-15	0	0
Financing cash flow	**4,935**	**-176**	**-1,984**	**-1,601**	**-1,852**
Borrowings	-1,468	-172	-695	0	0
Dividends paid	-697	-1,153	-1,383	-1,614	-1,844
Change in cash	**5,762**	**-2,196**	**378**	**1,975**	**2,006**
Balance Sheet (RsM)					
Total assets	**14,535**	**18,301**	**20,703**	**24,430**	**28,349**
Cash & cash equivalent	6,494	4,297	4,676	6,650	8,656
Accounts receivable	2,071	2,532	3,339	3,721	4,169
Net fixed assets	4,762	7,668	8,832	9,878	11,067
Total liabilities	**2,560**	**3,211**	**2,649**	**3,087**	**3,458**
Accounts payable	0	0	0	0	0
Total Debt	867	695	0	0	0
Shareholders' funds	**11,975**	**15,090**	**18,054**	**21,344**	**24,891**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	69.9	68.7	68.5	68.4	67.8
ROE adjusted	32.8	24.7	27.2	25.7	23.9
ROIC adjusted	39.5	34.5	32.6	34.1	33.9
Net debt to equity	-47.0	-23.9	-25.9	-31.2	-34.8
Total debt to capital	6.8	4.4	0.0	0.0	0.0

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Powered by: dataCentral

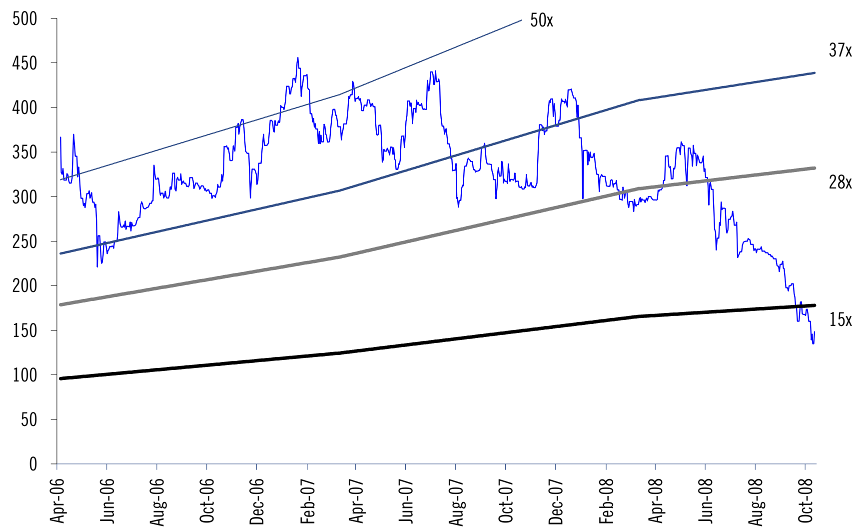
Upgrade to Buy: Regional Powerhouse

Post a strong Q2 and underperformance of c13% to Sensex YTD, we upgrade Sun TV Network to Buy/Medium Risk with a target price of Rs.185. We like Sun for (a) Dominance in South Indian market. (b) High profitability – net margins of c40% and RoE of 27%. (c) Leverage to DTH – we expect DTH related revenues of Rs. 1.3b (which has very high margins) in FY10. (d) Healthy balance sheet with net cash of ~Rs. 4b+. (e) EPS CAGR of ~18% over FY08-FY11E trading at ~12x FY10E.

2QFY09 results were strong – 30% advertising revenue growth with a rebound in cable subscription revenues (+20% sequentially) resulted in EBITDA margins of 75% and PAT growth of 35% yoy.

Despite a solid quarter, we have lowered our FY10 & FY11 EPS estimates by 8% and 13% to factor in the impact of a slowing economy on advertising spends. We now model in 18%, 15% and 12% advertising revenue growth in the rest of FY09, FY10 and FY11, respectively. The key risks to our call are (a) increasing competition affecting Sun's viewership ratings, (b) impact of rising costs on margins – we believe DTH related revenues should be able to compensate for the same and (c) change in political equations in the state.

Figure 1. Sun TV Network: One-Year Forward P/E Band Chart



Source: Powered by dataCentral

Target price of Rs.185

Our new target price of Rs.185 is based on 15x FY10E EPS – which is in-line with our target multiple for ZEEL. We benchmark Sun to ZEEL in the absence of any other relevant benchmark for regional broadcasters.

Case for premium to ZEEL

- Sun's margins/return ratios are superior.
- Sun's market share in its markets is much higher.
- Sun has a very strong content library for its relevant markets.

Case for discount to ZEEL

- Increasing competition could result in a decline in viewership ratings; cost of content is definitely going to go up.
- Changed political dynamics could affect Sun negatively (politics remains an important issue in South Indian media markets – as per our industry discussions).
- Sun's ad rates are significantly lower with Sun being a regional broadcaster.

We believe that there is a case for Sun to trade at par with ZEEL with Sun's regional strength counterbalanced by ZEEL's all India-based presence. We value Sun at 15x FY10E EPS – our target price is Rs.185

Our DCF based analysis suggests a fair price of Rs.183.

Figure 2. Sun TV Network (Consolidated): DCF Valuation

(Rs. m)	FY09E	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E	FY18E
EBIT	5,726	6,773	7,508	8,298	9,128	9,996	10,895	11,820	12,765	13,720
Working Capital increase	712	269	352	362	369	373	374	371	365	354
NOPAT	3,722	4,402	4,880	5,393	5,933	6,497	7,082	7,683	8,297	8,918
Depreciation	1,534	1,678	1,877	2,047	2,137	2,221	2,300	2,372	2,435	2,489
Capex	-2,697	-2,724	-3,066	-2,850	-2,959	-3,058	-3,145	-3,218	-3,276	-3,316
FCF	1,847	3,087	3,339	4,229	4,742	5,287	5,863	6,465	7,092	7,736
Discount rate	1.00	1.13	1.28	1.45	1.64	1.86	2.10	2.38	2.69	3.04
PV of FCF	1,847	2,728	2,607	2,918	2,891	2,848	2,791	2,719	2,636	2,541
Terminal Value	28,815									
Current cash (FY09 end)	4,676									
DCF based fair value	60,016									
Target price per share	**183**									
Number of Shares	394.1									
Cost of Capital	13.2%									
Terminal growth	4.0%									

Source: Citi Investment Research

Moderating growth assumptions

With the Indian economy expected to slow further (please find our economics team's note at: https://www.citigroupgeo.com/pdf/SAP21024.pdf), we have lowered our advertising growth forecast for Sun to 18%, 15% and 12% for the rest of FY09, FY10 and FY11 respectively. We leave our subscription unchanged primarily as DTH continues to be the key growth driver there, and we expect DTH ramp-up to continue.

Due to the above changes, we are lowering our EPS estimates for FY10 and FY11 by 7% and 12% respectively.

Figure 3. Sun TV Network (Consolidated): Earnings Revision Summary

Year to 31-Mar	Net Profit (Rs Mils.) Old	New	% Chg	Diluted EPS (Rs) Old	New	% Chg	Dividend Per Share (Rs) Old	New	% Chg
2009E	4,349	4,347	-0.1%	11.04	11.03	-0.1%	3.0	3.0	0.0%
2010E	5,248	4,904	-6.6%	13.32	12.44	-6.6%	3.5	3.5	0.0%
2011E	6,125	5,391	-12.0%	15.54	13.68	-12.0%	4.0	4.0	0.0%

Source: Citi Investment Research

Strong Q2 results – key highlights

- Advertising and broadcast sales revenue growth accelerated to 30% yoy from ~20% yoy in Q1.
- DTH related revenues increased qoq – management indicated that it would have billed ~1.8m subscribers – implies a quarterly revenue of Rs.135m (up ~20% sequentially). Growth should accelerate as the billing from Bharti Airtel and Reliance ADAG group DTH ventures starts coming in.
- Cable subscription revenues recovered well with ~20% growth sequentially. This was a big concern for investors as Q1 had witnessed a sharp decline in the same.

Figure 4. Sun TV Network (Parent): 2QFY09 Results Review (Rupees in Mn, Percent)

Rs Mn	2Q FY08	2Q FY 09	%yoy	Comments
Net Sales	**1944.5**	**2378.8**	**22.3**	Ad revenues+ Broadcast sales moved uo 30%yoy, Subscription went up 20% QoQ
Total Expenditure	-546.2	-615.5	12.7	
Operating Profit	**1,398.3**	**1,763.3**	**26.1**	
Operating Margin (%)	*71.9*	*74.1*	*222 bps*	
Other Income	143.1	371.5	159.6	About half of other income is due to one offs like sale of fixed assets & reversal of bad debt
Interest	-14.7	-20.7	40.8	
Depreciation and Amortisation	-248.3	-463.7	86.7	High amortisation as the no of movies acquired were high, including a no of big budget films
PBT	**1,278.4**	**1,650.4**	**29.1**	
Tax	-476.8	-567.3	19.0	
Tax Rate (%)	*37.3*	*34.4*	*-292 bps*	
PAT	**801.6**	**1,083.1**	**35.1**	Strong profit growth of 35%Y/Y, 5% QoQ growth
Cost Details				
Cost of Revenues	151.8	218.6	44.0	
% of sales	*7.8*	*9.2*	*138 bps*	
Staff Costs	175.0	256.2	46.4	
% of sales	*9.0*	*10.8*	*177 bps*	
Other Expenditure	219.4	140.7	-35.9	Sharp decline in the other expenditure led to a strong operating margin expansion
% of sales	*11.3*	*5.9*	*-537 bps*	

Source: Company Reports and Citi Investment Research

Sun's movie venture, Sun Pictures, started this quarter with the release of one movie. The management targets about 4 low to mid budget movies for FY09 and would be looking at Rs300-400m revenue per annum from the venture. The company plans to expense the entire movie in the year of release. We have not yet built this venture into our estimates.

In December, Sun TV Network is also planning to launch kids channels in other languages besides Tamil.

Figure 5. Sun TV Network: All Channels

Language	General Entertainment	News	Movies	Music	Kids
Tamil	Sun TV	Sun News	K TV	Sun Music	Chutti TV*
Telugu	Gemini TV, GCV	Gemini News, Teja News	TejaTV	Gemini Music, AdityaTV	
Kannada	Udaya TV,	Udaya News, Udaya Varthagalu	Udaya Movies, Ushe	Udaya 2*	
Malayalam	Surya TV*		Kiran TV* (music also)		

Source: Company Reports; * are Free to air (FTA) channels

Sun TV Network

Company description

Sun TV Network (Sun) is the dominant broadcaster in the South Indian states of Tamil Nadu, Kerala, Karnataka and Andhra Pradesh, enjoying almost monopolistic advantage in some key segments. Sun has the largest broadcasting platform in South India and operates 20 channels in South Indian languages, encompassing key genres like general entertainment, cinema, news, music and kids programs. It began as a single-channel company in Tamil Nadu in 1993, and has evolved into a multi-language and multi-genre broadcaster. Besides TV broadcasting, Sun also has interest in radio and owns FM radio licenses for 45 cities.

Investment strategy

We rate Sun Buy/Medium Risk (1M), with a target price of Rs185. It is the dominant South Indian broadcaster, and has enjoyed strong leadership in its markets. We believe that Sun TV will be one of the biggest beneficiaries of the pay market (particularly DTH) ramp up in India. Sun has successfully worked with the free commercial time (FCT) model. We expect advertising revenue growth at 19% CAGR over FY08-FY10E through annual rate increases and superior content/viewership ratings. With huge demand for regional channels in international markets, we expect pay revenues to keep growing at a robust ~25% CAGR over FY08-FY10E.

Valuation

Our target price of Rs185 is based on 15x FY10E P/E, derived from a c10% premium to global broadcasting peers' P/E averages, and at par with Zee Entertainment. We ascribe a premium to the global in recognition of Sun's superior earnings profile and higher capital efficiency. We have also looked at DCF analysis for Sun; strong/predictable cash flows imply that DCF is one of the better ways to value Sun TV Network. Our DCF based target price for Sun TV is Rs183, which is based on 4% terminal growth and 13.2% WACC.

Risks

We rate Sun TV Medium Risk based on our quantitative risk-rating system, which tracks 260-day historical share-price volatility. Key downside risks are: 1) With new competition coming in various states, Sun TV could lose market share as channel fragmentation would be in play 2) We believe that the sharp ramp up in DTH-related pay revenues should be able to compensate for increases in the cost of content. However, a sharper-than-expected increase in cost of content (particularly movies) could pressure on margins. 3) Any adverse change in political equations could hurt Sun TV. 4) Entry into Hindi GEC segment could change financials such as margins, return ratios and cash flow.

Zee Entertainment (ZEE.BO; Rs143.85; 1M)

Valuation

Our target price for ZEEL is Rs185 based on 15x FY10E EPS. Zee has traded in a valuation band of 15-39x post improvement in its viewership ratings (post June-2006). With increased competition (post Viacom 18's Colors coming in) and slowing economy, we value ZEEL at the lower end of its historical band. Our target multiple for ZEEL implies 25% premium to global comparables to account for the better market opportunity in India given the lower penetration and ZEEL’s superior expected growth rates.

Risks

We rate Zee Medium Risk based on our quantitative risk-rating system that tracks 260-day historical share price volatility. The following risks could impede the stock from reaching our target price: 1) Zee's improved TV ratings resulted in a sharp revival in ad revenues, with Zee hiking rates over the past few years. Loss of market share to competition would result in lower ad revenue growth. 2) Delays in CAS rollouts could result in a slower-than-expected ramp-up in pay revenues. While recent press reports suggest roll-out of CAS in 55 cities, we remain cautious as CAS implementation has witnessed significant delays in the past. Set-top-box supply could also hold back ramp-up of CAS. 3) Competitive intensity could result in higher costs (in the form of new channels or higher costs in existing channels) and take a toll on Zee's margins.

Appendix A-1

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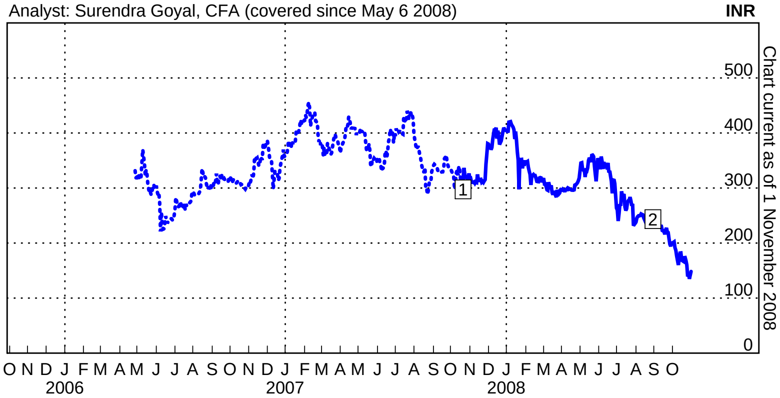
IMPORTANT DISCLOSURES

Sun TV Network (SUTV.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Surendra Goyal, CFA (covered since May 6 2008)



Covered
Not covered
Rating/target price changes above reflect Eastern Standard Time

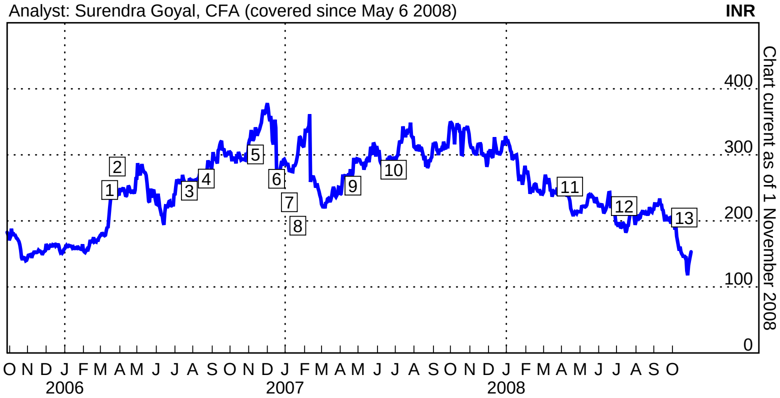
#	Date	Rating	Target Price	Closing Price
1:	22 Oct 07	3M	304.00	314.75
2:	29 Aug 08	*2M	*268.00	238.70

*Indicates change.

Zee Entertainment (ZEE.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Surendra Goyal, CFA (covered since May 6 2008)



Covered
Not covered
Rating/target price changes above reflect Eastern Standard Time

#	Date	Rating	Target Price	Closing Price
1:	16 Mar 06	3H	*97.50	219.15
2:	29 Mar 06	*1L	*167.55	239.55
3:	26 Jul 06	1L	*197.33	264.15
4:	23 Aug 06	1L	*233.52	273.10
5:	13 Nov 06	1L	*240.53	341.65
6:	18 Dec 06	1L	*290.83	272.20
7:	8 Jan 07	1L	*224.21	274.50
8:	22 Jan 07	1L	*250.72	301.95
9:	23 Apr 07	1L	*277.00	272.95
10:	28 Jun 07	1L	*354.00	287.55
11:	15 Apr 08	1L	*306.00	230.35
12:	14 Jul 08	*1M	*240.00	194.55
13:	21 Oct 08	1M	*185.00	147.75

*Indicates change.

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% of companies in each rating category that are investment banking clients	48%	48%	40%

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