IDFC INSTITUTIONAL SECURITIES

India Research

Zee Entertainment Enterprises

Rs118
DOWNGRADE TO NEUTRAL

RESULT NOTE

Mkt Cap: Rs115.4bn; US$2.56bn

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Result: **Q3FY11**

Comment: **Sports business loses at Rs1.03bn!**

Key financials

Year to March 31 (Rs mn)	Revenues	yoy chg (%)	Net profit	EPS (Rs)	yoy chg (%)	PER (x)	EV/E (x)
FY09	21,773	18.6	5,124	11.8	33.5	20.0	19.4
FY10	21,997	1.0	6,344	14.6	23.8	16.1	15.8
FY11E	28,783	30.9	5,654	5.8*	(60.4)	20.4	15.5
FY12E	32,970	14.5	6,688	6.8	18.3	17.3	11.8

**Adjusted for bonus issuance in Nov 2010; Historical valuation ratios adjusted*

Key highlights of Q3FY11 results and our interaction with the management

- Zee Entertainment (ZEEL) reported a disappointing set of numbers for Q3FY11. While operational revenues are in line with estimates, higher than expected losses in the sports business have resulted in EBITDA and PAT coming lower than estimates.
- In Q3FY11, ZEEL has reported operational revenues of Rs7.55bn (estimates of Rs7.53bn), EBITDA of Rs1.54bn (estimates of Rs2.19bn) and operational PAT of Rs1.1bn (estimates of Rs1.56bn). As these numbers include financials of Regional GEC and exclude the education business, they are not comparable with historical financials.
- Reported revenues include Rs700m of one-time revenue from the sports business. Thus, reported PAT (post minority interest) stood at Rs1.5bn for Q3FY11.
- In line with expectation, advertising revenues have come in at Rs4.4bn (estimates of Rs4.3bn) and subscription revenues at Rs2.82bn (estimates of Rs2.86bn). Revenues from other sales and services came in marginally lower than expectations at Rs333m (estimates of Rs370m)
- DTH revenues during the quarter registered a 4.3% QoQ growth at Rs821m (estimates of Rs852m). ZEEL has entered into a fixed fee deal with only one DTH operator – Dish TV – for which the pricing is re-negotiated on an annual basis (for the rest, its on a per-subscriber basis). **With Dish TV accounting for almost 30% of entire DTH market, we believe ZEEL is capping its potential upside from DTH, implying that the deal is sub-optimal for ZEEL. We believe that this will need to correct over the course of the next 12 months.**
- Revenues from cable distribution for the quarter stood at Rs986m (Rs961m in Q2FY11) and international revenues stood at Rs1.01bn.
- Reported revenues for the quarter include a one-time income of Rs700 in the sports business. This is pertaining to the sports telecast rights of I-League (Indian football league), whose first season was aired in FY08. ZEEL had signed a 10 year agreement with the All India Football Federation (AIFF) for domestic telecast rights of I-League (deal value estimated to be ~USD70m). In December 2010, the AIFF roped in IMG-RIL (a JV between IMG, a global sport marketing company, and RIL) as their commercial partner by signing a 15year agreement (deal value estimated at

~USD155m). For this, IMG-RIL gave a buyout amount of Rs700m to ZEEL to exit the agreement with AIFF before maturity.

- With respect to operating costs, content costs have seen a sharp increase from Rs3.45bn in Q2FY11 to Rs4.15bn in Q3FY11. The increase in costs during the quarter is largely on account of the sports business (wherein overall opex has increased from Rs1.73bn in Q2FY11 to Rs1.99bn in Q3FY11) as also addition of fresh hours of content on the flagship channel – Zee TV. Important to note that sports opex in Q2FY11 included launch expenses for the two new sports channels. Overall operating expenditure for the quarter stood at Rs6bn against Rs5.2bn in Q2FY11.
- With respect to the sports business, operational losses have significantly widened to Rs1.03bn (revenues of 965m) in Q3FY11 against Rs542m in Q2FY11. The high losses are primarily attributable to the India-SA series which have a significant cost. As the property continues to be on-air currently (in Q4FY11), operational costs in sports business and thereby overall content cost for ZEEL would continue to remain firm in Q4FY11. For 9mFY11, ZEEL has garnered operational losses of Rs1.9bn in the sports business.
- Content cost pressure has resulted in EBITDA margins correcting sharply from 29.6% in Q3FY10 (and 26.5% in Q2FY11) to 20.4% in Q3FY11. This has been the lowest margins reported by ZEEL in the last 16 quarters!
- During the quarter, other income stood at Rs232m and interest cost stood at Rs24m.
- *Zee TV's* average GRPs during the quarter stood at 200 which is a 16% decline on a QoQ basis. In Q3FY11, *Zee TV* has witnessed strong competition in the Hindi GEC segment and has been displaced from the third position in the segment by *Sony*. While *Zee TV* has shown some recovery in the last 2 weeks, we believe sustainability of the same is imperative as pressure in viewership could potentially impact ad yields (and/or increase investments towards content) and thereby the overall profitability.
- *Zee Marathi* continued to maintain its leadership position with average GRPs of 209, while *Zee Bangla* has lost its leadership position to *Star Jalsa* (2nd with 33% market share). *Zee Telugu's* GRPs were at 344 with a channel share of 18%. *Zee Kannada* averaged GRPs of 178 during the quarter.
- Factoring in the increased losses in the sports business, we have downgraded our EPS estimates by 11% for FY11 and 10% for FY12. Our revised EPS stands at Rs5.8 for FY11 and Rs6.8 for FY12.

Intensified competition in the Hindi GEC space (with Sony displacing Zee TV from No.3 position) and continuing bleed in the sports business (Rs1.9bn of losses in 9mFY11!) are clear signs of pressure on ZEEL's business. While ZEEL has been able to sustain a strong revenue growth on the back of the buoyant ad environment and strong subscription income flow (albeit cap on DTH revenue stream due to sub-optimal deal with Dish TV), profitability of the business is becoming a serious concern (EBITDA margins of 20.4% in the current quarter). Decline in viewership ratings for ZEE TV over the past few months makes us apprehensive as it could potentially impact ad yields (and/or increase investments towards content) and thereby the overall profitability of the business. With current state of operations implying pressure on profitability for ZEEL in the near term (sports business losses to continue), we see more merit in buying a basket of IBN18 and Sun TV. IBN18 imparts the sharpest delta in subscription revenues and Sun TV a strong mix of consistent ad revenue growth backed with an annuity income from subscription. Factoring the increased losses in the sports business as also cost pressures in the core business, we have downgraded our EPS estimates by 11% for FY11 and 10% for FY12. With business fundamentals looking weak and limited visibility on recovery of the sports business, we downgrade our call on ZEEL to Neutral. The stock trades at 17x FY12E earnings.

Quarterly results

Rs (m)	Q3FY10	Q4FY10	FY10	Q1FY11	Q2FY11	Q3FY11	FY11E	FY12E
Advertising Revenues	2,707	3,517	10,680	3,769	4,122	4,398	16,394	19,181
Subscription revenues	2,467	2,513	9,958	2,614	2,737	2,818	11,194	12,474
Other operational income	135	463	1,359	387	257	333	1,195	1,315
Net Sales	**5,309**	**6,493**	**21,997**	**6,770**	**7,116**	**7,549**	**28,783**	**32,970**
% yoy growth	*(2.7)*	*26.4*	*1.0*	*42.2*	*31.7*	*42.2*	*30.9*	*14.5*
Expenditure	3,737	4,657	15,863	4,900	5,230	6,008	21,745	23,530
EBITDA	**1,573**	**1,836**	**6,134**	**1,870**	**1,886**	**1,541**	**7,038**	**9,439**
Margin (%)	29.6	28.3	27.9	27.6	26.5	20.4	24.5	28.6
Other Income	323	291	1,220	126	240	232	793	912
Interest	65	110	331	51	5	24	100	100
Depreciation	76	56	285	62	56	78	283	345
PBT	**1,754**	**1,961**	**6,737**	**1,883**	**2,064**	**1,672**	**7,449**	**9,907**
Tax	603	662	573	673	801	818	2,785	3,269
Minority interest	(100)	25	(179)	38	1	(45)	-	(50)
Exceptional items	(313)	11		291	-	700	991	
PAT	**1,564**	**1,263**	**6,344**	**1,539**	**1,264**	**1,509**	**5,654**	**6,688**
% yoy growth	*41.6*	*43.8*	*24.4*	*32.5*	*13.9*	*(25.8)*	*(10.9)*	*18.3*

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