Company

21 July 2010 | 8 pages

# Zee Entertainment (ZEE.BO)

Equity

## Hold: Advertising Rebounds; Will Costs Follow?

- **1QFY11 below expectations** — Recurring PAT of Rs1.21bn (+33% YoY) was below both our and street estimates of Rs1.44bn and Rs1.39bn respectively. The variance was due a lower-than-forecast EBITDA and low other income (included FX loss of ~Rs40m). Reported PAT was higher at ~Rs1.5bn as it included one-time profit on sale of investments in Asianet Communication.
- **Advertising revival visible** — Reported revenues rose 42% YoY to Rs6.8bn driven by robust advertising growth (low base of 1QFY10 + ad market pick up + higher contribution from the regional channels). Assuming ad revenue contribution of ~Rs1bn from R-GECs (around 4QFY10 levels), the like-for-like ad revenues growth for the base business appears to be a solid ~35-40% YoY.
- **DTH drives subscription revenues** — a) Recurring DTH revenues increased by 9% QoQ to Rs710m— mgmt mentioned that ZEEL currently has a fixed-rate agreement only with Dish TV. b) International revenues (-8% YoY) were impacted by adverse currency movements; constant currency growth was +3% YoY. c) Domestic cable revenues reported a pick up (+9% QoQ). Mgmt reiterated its guidance of flat to marginal growth YoY in domestic cable revenues in FY11.
- **Margin expands 300bps YoY, but lower than estimates** — Despite better revenues, EBITDA margin expansion of ~300bps YoY to 27.6% was lower than estimates given the increase in staff and selling expenses on YoY basis. Sports business performance was a dampener with its quarterly loss of ~Rs350m.
- **Key focus areas** — a) We believe buoyancy in the industry could lead to higher costs going forward. Mgmt expects 15% YoY cost increase ex sports in FY11. b) Sports performance is key – mgmt expects losses lower than FY10 levels. We would look for benefits accruing due to synergies post Taj TV stake increase and given the planned line-up. c) Sustaining market shares in key channels (Zee TV, Zee Bangla) is important, given the competitive intensity/ fragmentation.

| Hold/Medium Risk | 2M |
|---|---|
| Price (21 Jul 10) | Rs311.90 |
| Target price | Rs340.00 |
| Expected share price return | 9.0% |
| Expected dividend yield | 1.3% |
| **Expected total return** | **10.3%** |
| Market Cap | Rs135,367M |
| | US$2,863M |

**Price Performance (RIC: ZEE.BO, BB: Z IN)**


**Statistical Abstract**

| Year to 31 Mar | Net Profit (RsM) | Diluted EPS (Rs) | EPS growth (%) | P/E (x) | P/B (x) | ROE (%) | Yield (%) |
|---|---|---|---|---|---|---|---|
| 2008A | 3,858 | 8.90 | 62.4 | 35.0 | 4.7 | 14.1 | 0.6 |
| 2009A | 3,673 | 8.46 | -4.9 | 36.9 | 4.0 | 11.7 | 0.6 |
| 2010E | 4,485 | 10.33 | 22.1 | 30.2 | 3.5 | 12.3 | 1.3 |
| 2011E | 6,725 | 13.75 | 33.1 | 22.7 | 3.5 | 16.4 | 1.3 |
| 2012E | 7,696 | 15.74 | 14.4 | 19.8 | 3.1 | 16.7 | 1.3 |

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

# 1QFY11 Results Summary

**Figure 1. ZEEL (Consolidated): 1QFY11 Results Summary (Rs Mn, %)**

| | 1Q10 | 1Q11 | % Change YoY |
|---|---|---|---|
| Revenues | 4,759 | 6,770 | 42.2% |
| - Advertising revenue | 1,980 | 3,769 | 90.4% |
| - Subscription revenue | 2,410 | 2,614 | 8.5% |
| - - - Domestic cable revenue | 851 | 894 | 5.1% |
| - - - DTH related revenue | 467 | 710 | 52.0% |
| - - - International sub revenue | 1,092 | 1,010 | -7.5% |
| **EBITDA** | **1,170** | **1,870** | **59.8%** |
| *EBITDA margin* | *24.6%* | *27.6%* | *304bp* |
| **EBIT** | **1,095** | **1,808** | **65.1%** |
| *EBIT margin* | *23.0%* | *26.7%* | *370bp* |
| **Recurring Profit** | **913** | **1,210** | **32.5%** |
| PAT after Minority interest | 1,019 | 1,249 | 22.5% |
| Exceptional gains | - | 291 | nm |
| **Reported PAT** | **1,019** | **1,539** | **51.1%** |

Source: Company Reports

## Notes from the Management Conference Call

- Net cash on books was ~Rs7.92bn. Mgmt mentioned that cash may be used potential inorganic opportunities; while stated that nothing substantial was on the cards in the immediate term. The new channels launches planned do not require too much cash. In case of no M&A/tie-ups, mgmt plans on good dividend payout.
- The quarterly other income should remain at current levels for the rest of the year.
- ZEEL aims to grow ad revenues ahead of the market; which is expected to grow at ~15% YoY.
- Employee costs are likely to be smoother in FY11. Last fiscal, a large part of the incentives were bunched up in 4Q.
- ZEEL plans to explore business opportunities in digital distribution of content. Mgmt has entered into a JV (60% holding by ZEEL) with Geodesic – believes that this has potential given the 3G roll out.
- During the fiscal, company plans on only maintenance capex of ~Rs600-800m.

# Zee Entertainment

## Company description

Zee Entertainment (ZEEL) is one of India's largest vertically-integrated media and entertainment companies. It has an integrated range of businesses, encompassing the content-to-consumer value chain of media and entertainment. It owns a number of channels across various genres including general entertainment (both national and regional), cinema, music, news and sports. Zee has aggressive plans in the motion picture business through its subsidiary, Zee Studio (ZES), which works under two banners - Zee Motion Pictures and Zee Limelight.

## Investment strategy

We rate ZEEL Hold / Low Risk (2M). While we believe ZEEL is one of the best-placed Indian media companies, with significant leverage to DTH/pay TV theme, the strong stock performance over the last 12 months factors in a lot of positives. We think that post ~13% YoY decline in advertising in CY09E, ZEEL's advertising revenue growth is likely to witness a sharp pick-up over the next 12-18 months, given the improving economy, the groups' steady ratings and accretion due to regional channels (R-GECs) integration. We think the positives from the improved balance sheet position and good near-term growth are discounted in the current valuations.

## Valuation

Our target price for ZEEL is Rs340 is based on 23x Sept11E consolidated EPS. ZEEL has traded in a valuation band of 10x-39x post improvement in its viewership ratings (i.e. post 2005). ZEEL's premium to market PE is now above its trailing five-year historical average (~40% premium), largely factoring in benefits from the turnaround in the domestic advertising market and benefits of rising digitalization through DTH growth. We believe the consolidation of R-GECs diversifies ZEEL's revenue base and augments its growth rates.

Our target multiple for ZEEL implies a ~35% premium to global peers. We believe this is justified by the better market opportunity in India, given the lower penetration and ZEEL's superior expected growth rates. ZEEL's target multiple is at a slight discount of ~5% to that we ascribe to Sun TV Network, given the latter's dominance in higher growth markets and better margin profile.

## Risks

We rate ZEEL Low Risk, instead of High Risk as suggested by our quantitative risk-rating system that tracks 260-day historical share price volatility. We think this is justified given ZEEL's improving balance sheet position (net cash of Rs5.2bn at end FY10) and firm position in key markets.

Key upside risks include: (1) better-than-expected synergies flowing through in the sports business, post the Ten Sports stake increase, could aid profitability; (2) any value accretive acquisition in the near term; (3) Faster-than-anticipated digitalization through the increase in number of DTH subscribers could result in better operating leverage. Downside risks to our target price include: (1)

Sustenance of viewership share will be key for advertising revenue growth; (2) If buoyancy in the industry continues, ZEEL's cost structure may need to increase; (3) FY11E is a big year in sports, which could eat into Hindi/regional GECs' advertising pie.

# Dish TV

## Valuation

Dish TV operates in an industry at a nascent stage with high growth rates (on a small base), so we do not use equity multiples approach as our primary valuation methodology, given that current financials would not truly reflect the value of the business. We thus think a DCF would be best suited, giving a target price of Rs48 per share (WACC = 11.7% and g = 4.5%). The stock will trade at 13x FY12E EV/EBITDA at our target price, which we think is reasonable given (a) high growth in the business, (b) We expect margins to hit ~25% in FY12E, and, (c) Positive FCF FY12E onwards as the business achieves critical size. At our target price, Dish TV would trade at 3.9x/3x FY11E/FY12E EV/Sales, which is at a premium to global peers trading between 1-3x. We think this is justified given the superior revenue growth outlook (~26% CAGR over FY10-12E for Dish TV v/s. global C&S average of ~7%).

## Risks

We rate Dish TV shares Medium Risk overriding the High Risk rating suggested by quantitative risk-rating system that tracks 260-day historical share price volatility. We think this is warranted given Dish TV's strong leadership position in India's DTH industry. As funding concerns are behind us, a lower risk rating is justified. Key downside risks are: 1) Irrational competition may negatively impact ARPUs and churn. 2) Dish TV imports most of its consumer premise equipments (dollar denominated), and thus, currency fluctuations could significantly impact profitability. 3) The DTH industry is highly regulated and adverse changes in government policies may impact business prospects. 4) Investments in subsidiaries and group companies could be an overhang.

# Appendix A-1

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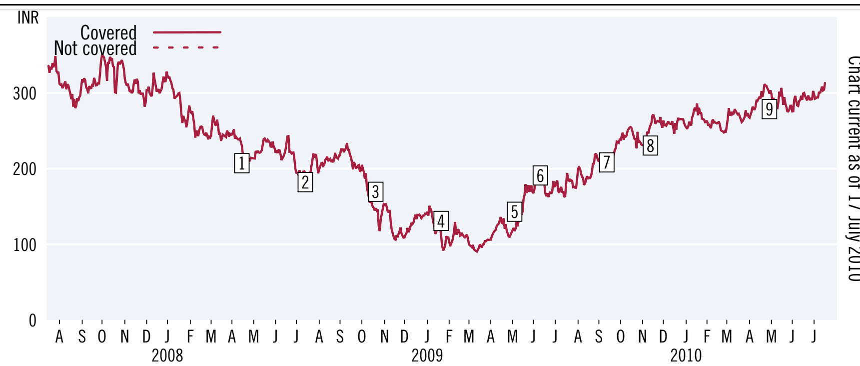
**Fundamental Research**

Analyst: Surendra Goyal, CFA
Covered since May 6 2008




| | Date | Rating | Target Price | Closing Price |
|---|---|---|---|---|
| 1 | 15-Apr-08 | 1L | *306.00 | 230.35 |
| 2 | 14-Jul-08 | *1M | *240.00 | 194.55 |
| 3 | 21-Oct-08 | 1M | *185.00 | 147.75 |
| 4 | 21-Jan-09 | *3M | *105.00 | 110.05 |
| 5 | 5-May-09 | *1M | *145.00 | 117.80 |
| 6 | 10-Jun-09 | 1M | *228.00 | 187.30 |
| 7 | 11-Sep-09 | 1M | *255.00 | 209.40 |
| 8 | 12-Nov-09 | 1M | *300.00 | 257.20 |
| 9 | 29-Apr-10 | *2M | *340.00 | 299.15 |

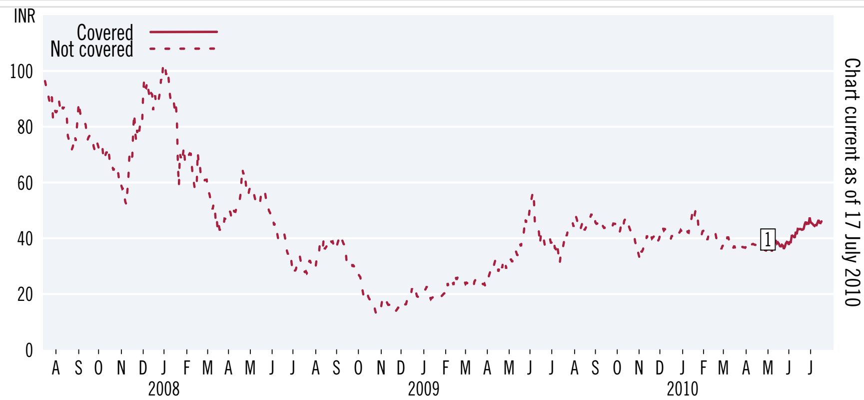
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

### Dish TV (DSTV.BO)

**Ratings and Target Price History**
**Fundamental Research**

Analyst: Surendra Goyal, CFA
Covered since May 1 2010




| | Date | Rating | Target Price | Closing Price |
|---|---|---|---|---|
| 1 | 1-May-10 | *1M | *48.00 | 35.90 |

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