

Adlabs Films

BUY
Maintained
Rs351

In the spotlight

Reason for report: Company update and Earnings revision

This report is based on recent meetings with the senior management across various business groups at Adlabs. Though FY07E numbers are being revised downwards, we would like to reiterate the extremely robust growth outlook. The revision largely reflects transitory impact of change in the M-plex rollout schedule, movie production plans and foray into FM radio pursuant to takeover by the Anil Dhirubhai Ambani Group and equity infusion during the past fiscal. In fact, post the structural and strategic realignment, Adlabs is even more strongly positioned across the movie value-chain – from production to processing, distribution & exhibition. While value unlocking in FM radio is a short-term trigger, foraying into television content enhances the medium-term upside. Reiterate BUY.

- **Box-office bumper harvest...boosts exhibition and distribution.** The YTD FY07 box-office show has been stellar and the line-up for the festive season (October-December '06) is equally impressive. The signs of audiences coming to terms with the M-plex 'sticker shock' through rising income and affordability, are positive and set the stage for a J-curve play-out. Besides, a step-up in rollout of 'mass-market' refurbishment format screens would capture potential in the 'B category' towns.
- **Movie processing, production gain from multiplex boom; TV content foray is timely.** The new processing facility in Chennai is off to a good start and a smaller facility in Kolkata has also been inaugurated. With more M-plexes, the number of prints per movie is rising and demand for movie content is all set to surge. Similarly, the advent of DTH/CAS would raise the bar for TV content and the recent acquisition of Synergy Communication (of *KBC* and *Jhalak Dikha Ja* fame) is the first step in this space, at a time when the broadcaster revenue pie is set to surge 47% over FY07E-09E.
- **Expect 52% CAGR in EBITDA and 33% in earnings through FY06-08E.** Our estimates factor in fairly conservative assumptions for occupancy & returns on production/distribution and do not account for FM radio & TV content potential. A sensitivity analysis indicates 100bps better M-plex occupancy boosts PAT by twice as much. Net of FM radio assets being de-merged, we see Adlabs' movie business RoCE expanding to 17.3% and RoE to 23.1% in FY08E.
- **Sum-of-the-parts target price at Rs395.** This includes Rs81/share for the FM radio entity. Accordingly, on post-demerger basis, Adlabs trades at an implied FY08E P/E of 17.1x. Maintain BUY.

Market Cap	Rs13.9bn/US\$305mn	Year to Mar	FY05	FY06	FY07E	FY08E
Reuters/Bloomberg	ADLF.BO/ADLF IN	Revenue (Rs mn)	981	1,213	2,680	4,112
Shares Outstanding (mn)	40	Net Income (Rs mn)	243	313	414	556
52-week Range (Rs)	455/189	EPS (Rs)	11.3	7.8	10.4	14.0
Free Float (%)	45.1	% Chg YoY	34.8	(30.8)	32.6	34.4
FII (%)	12.6	P/E (x)	31.0	44.8	33.8	25.1
Daily Volume (US\$/'000)	3,300	CEPS (Rs)	14.2	10.3	13.9	19.1
Absolute Return 3m (%)	30.6	EV/E (x)	18.2	30.5	25.2	17.4
Absolute Return 12m (%)	16.9	Dividend Yield (%)	1.0	0.6	1.0	1.3
Sensex Return 3m (%)	15.1	RoCE (%)	27.4	9.4	7.9	9.9
Sensex Return 12m (%)	45.3	RoE (%)	20.5	13.3	11.6	14.2

Media

Earnings revision

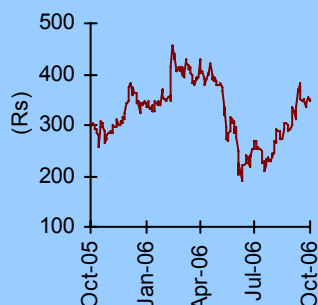
(%)	FY07E
Sales	↓ 9.5
EBITDA	↓ 20.9
EPS	↓ 35.0

Shareholding pattern

	Dec '05	Mar '06	Jun '06
Promoters	50.1	54.9	54.9
Institutional investors	15.5	16.4	16.9
MFs and UTI	5.1	5.2	4.3
Insurance Cos.	0.0	0.0	0.0
FII	10.5	11.2	12.6
Others	34.4	28.7	28.2

Source: www.nseindia.com

Price chart



Om Prakash Periwal

omprakash_periwal@isecltd.com
+91 22 6637 7339

R Amarnath

r_amarnath@isecltd.com
+91 22 6637 7114

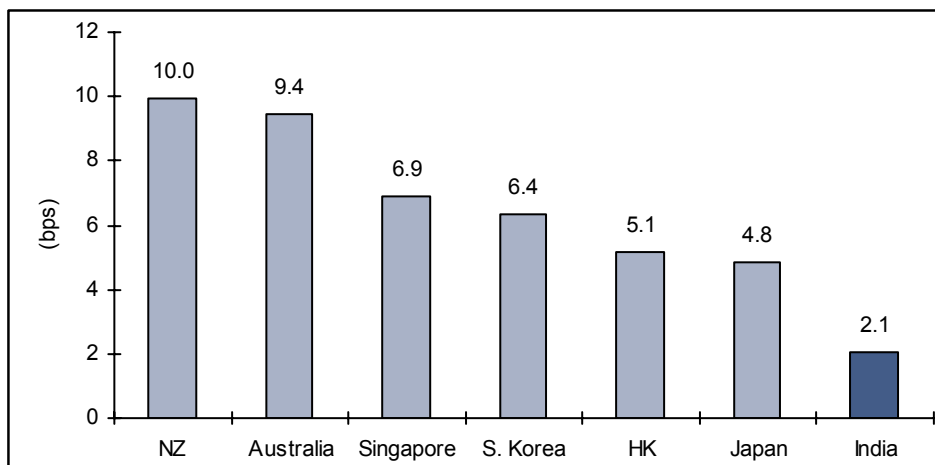
Box-office – Blockbuster year

A combination of better content coupled with high-voltage promos has reignited the box-office. Coupled with this, the revenue mix for good movies is more diversified today - while domestic box-office accounts for 50-55% (earlier 70%) of total revenues, satellite TV rights make up 20% and overseas territories 10-15%; the home video segment is also growing, accounting for 10% of revenues. As a result, the 'hit ratio' for *Bollywood* has significantly improved, attracting greater investments into Hindi movies. This in turn augurs well for superior content supply-chain, thereby boosting occupancy rates at multiplexes. Recently, there have been a few instances of producers demanding higher share of box-office revenues for their movies from M-plex operators. We note that such instances are few and far between and linked solely to extremely successful content (*Lage Raho Munnabhai* and *Fanaa*). In these circumstances, parting with a slightly higher share does not pinch as such blockbusters translate into a rise in ticket prices, enhanced occupancy and a longer run at the theatres. Thus, the exhibitors too actually benefit from a share of an enlarged box-office pie.

As per data available from industry websites, CY06 has been a blockbuster year for *Bollywood*, with almost one-half of releases labelled as 'successful' at the box-office versus just a third that earned this sobriquet last year. And, if H1FY07 had its long list of big budget movies to woo M-plex audiences, H2FY07 appears all set to deliver an encore and more. The second-half line-up through the festive season (October '06-January '07) includes *Don*, *Jaan-e-mann*, *Namaste London*, *Salaam-E-Ishq*, *Dhoom 2*, *Umrao Jaan*, *Babul* and *Guru* to name a few.

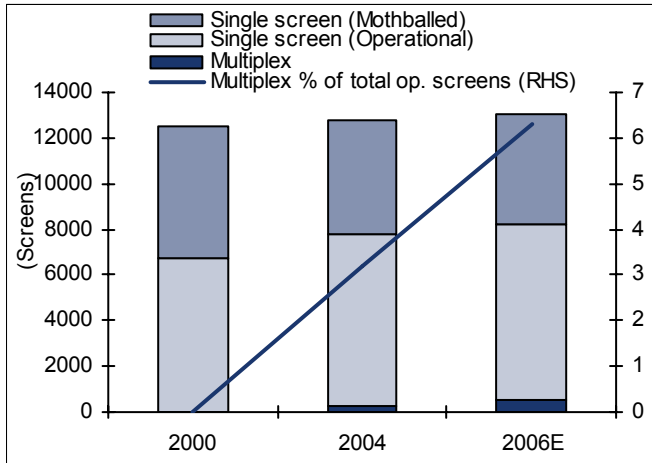
Chart 1: Box-office collections to GDP ratio

The extremely low ratio underscores the potential for a J-curve play-out in the medium term

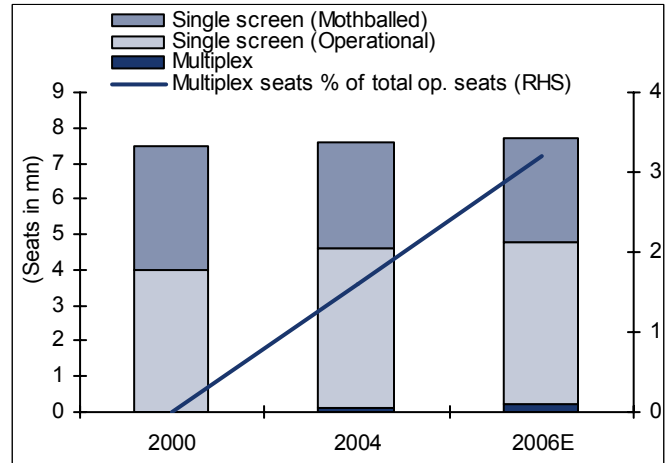


Source: PricewaterhouseCoopers LLP, Wilkofsky Gruen Associates, World Bank, i-SEC Research

Chart 2: Screens and seats – Unchanged at CY00 levels

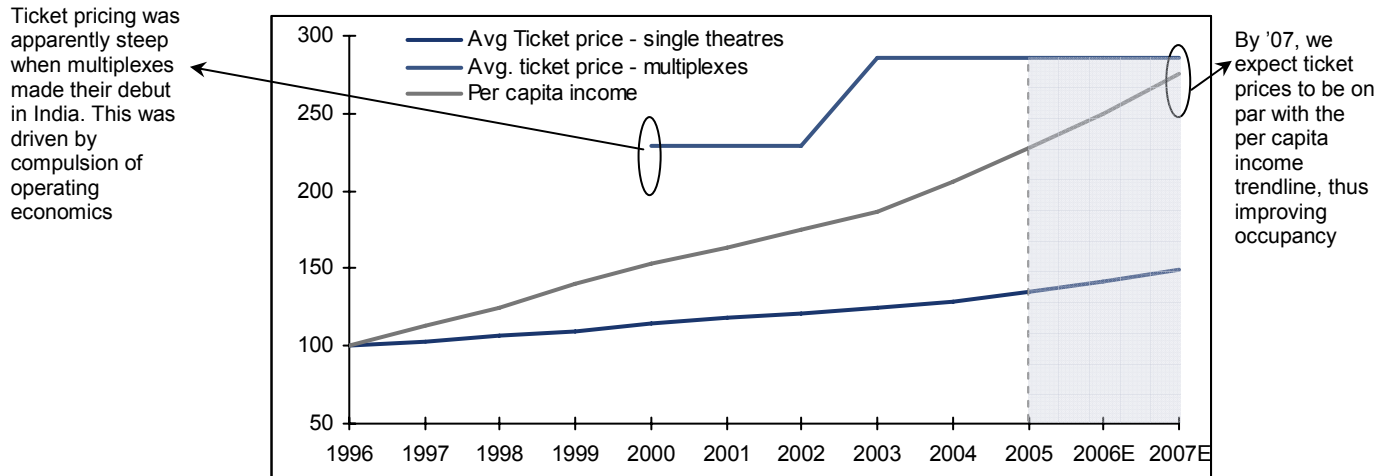


Source: Industry data, i-SEC Research



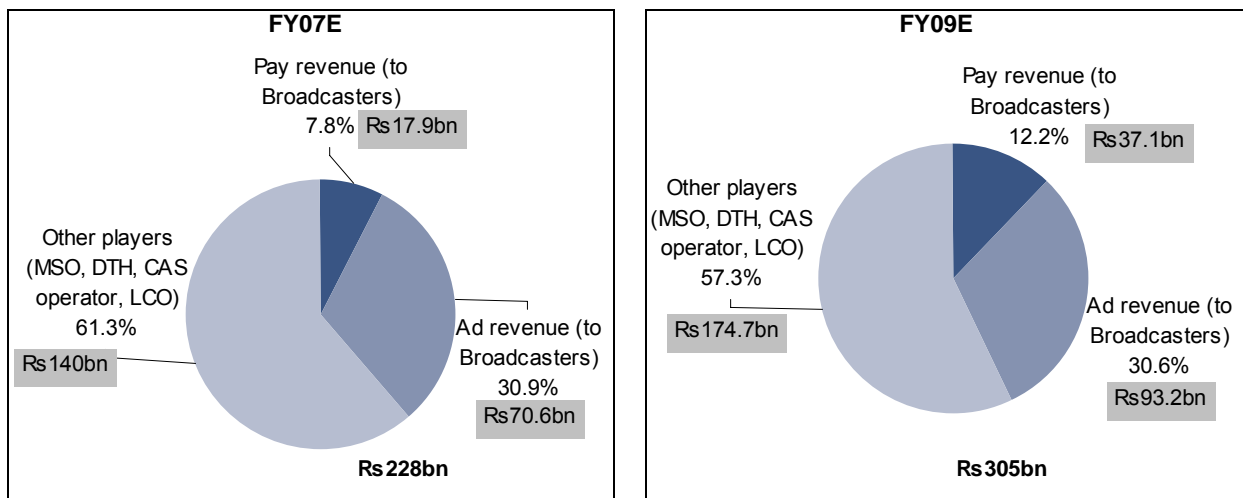
Source: Industry data, i-SEC Research

Chart 3: Rising per capita income to narrow 'affordability gap'



Note: All figures are indexed to base (1996 = 100) for ticket prices and per capita income
Source: World Bank indicators, CMIE, Industry estimates, i-SEC Research

Chart 4: Broadcaster revenues to surge 47% over FY07E-09E



Source: FICCI-PwC report *The Indian Entertainment and Media Industry*, '06, i-SEC Research

Table 1: Key assumptions

	FY07E	FY08E
No of screens		
Beginning of year		
<i>M plex</i>	34	68
<i>Refurbishment theatres</i>	-	12
End of year		
<i>M plex</i>	68	98
<i>Refurbishment theatres</i>	12	48
Ticket Prices (Rs)		
Mumbai	111	122
Other Metros	86	95
Other Cities	81	90
Refurbishment theatres	45	48
Occupancy Levels (%)		
Mumbai	40.0	41.0
Other Metros	37.5	38.3
Other Cities	35.0	35.7
Refurbishment	30.0	31.5

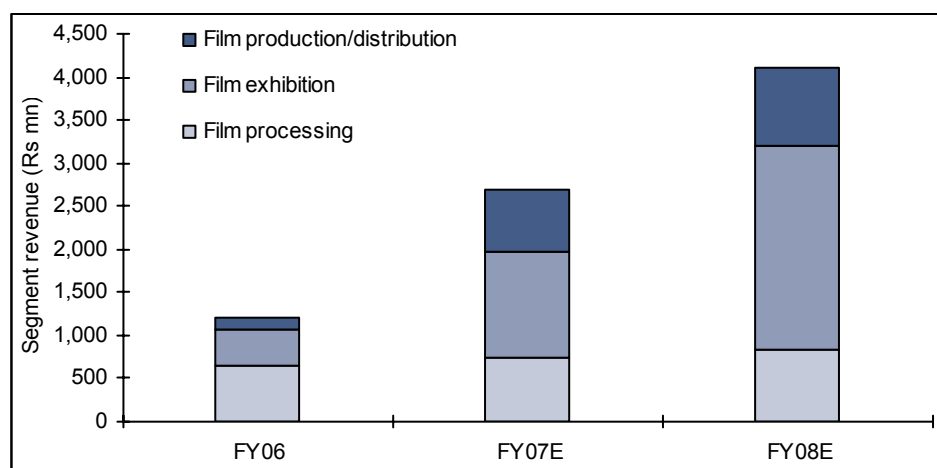
Source: i-SEC Research

The decline in earnings reflects a change in the M-plex rollout schedule after review of locations, formats in FY06 under the new management. Further, the entry into FM radio has resulted in funds being used as initial investments in that business, which would generate returns going forward

Table 2: Earnings revision*(Rs mn)*

	FY07E		% change
	Old	New	
Revenues	2,961	2,680	(9.5)
EBITDA	883	699	(20.9)
Recurring PAT	636	414	(35.0)
EPS (Rs)	16.0	10.4	(35.0)

Source: i-SEC Research

Chart 5: Segment wise revenue and EBITDA

EBITDA (Rs mn)	FY06	FY07E	FY08E
Film processing	262	320	338
Film Exhibition	170	236	532
Film Production/ distribution	34	142	199

Source: Company data, i-SEC Research

Table 3: Estimated FM Radio business balance sheet

(Rs mn)

Radio BIG is expected to have nine stations on air by October 15, '06 and all 45 stations by March '07

Radio BIG	FY07E
Share Capital (mn)	398
No of shares (mn)	80
Reserves & Surplus	1,304
Net Worth	1,702
Debt	2,500
Liabilities	4,202
Net Block	3,820
Net current Assets	382
Assets	4,202

Source: i-SEC Research

Table 4: Valuation and ratios, ex-FM business

Adjusted for de-merger of FM radio business, RoCE and RoE of film business to expand sharply

	FY07E	FY08E
Per Share Data (in Rs.)		
Diluted Recurring EPS	12.2	15.8
Recurring Cash EPS	15.7	21.0
Dividend per share (DPS)	3.4	4.6
Book Value per share (BV)	50.7	60.6
Growth Ratios (%)		
Operating Income	121.0	53.4
EBITDA	49.9	53.1
Recurring Net Income	31.9	34.4
Diluted Recurring EPS	55.9	29.3
Diluted Recurring CEPS	51.9	33.4
Return Ratios (%)		
RoCE	13.2	17.3
RoE	20.5	23.1
Valuation Ratios (x)		
P/E	22.1	17.1
P/CEPS	17.2	12.9
P/BV	5.33	4.46
EV / EBITDA	17.1	12.2
EV / Operating Income	4.4	3.2
EV / Operating FCF	(8.4)	(18.9)

Note: Above table is for Adlabs movie business valued at Rs270 per share i.e. after netting out FM radio at Rs81 per share from current market price of Rs351

Source: i-SEC Research

Table 5: Sum-of-the-parts valuation

Business segment	Rationale	Multiple	Value (Rs mn)	Comment
Film processing	DCF value		3,206	Valuation implies movie industry goes totally 'digital' in FY09 and cash accruals from this business <i>halve</i> thereafter with 3% terminal growth & WACC 11%
Film Exhibition	EV/E of FY08E	15.0	7,985	Growth trajectory to mirror mall, retailing consumption J-curve; at 10% discount to adjusted Pantaloon multiples
Film Production / Distribution	EV/E of FY08E	11.0	2,189	Multiple in line with 2 wheeler stocks
Value of stake in Prime Focus	At 10% discount to market value		146	
Less : Net debt			1,013	adjusted for advances of Rs2.5bn to FM radio entity (Table 3)
Equity value of the film businesses			12,513	Equivalent to Rs314 per share
Add : FM radio biz.	At 50% of current EV of ENIL		3,205	This implies a 36% premium to the total value of licences and rollout for Big FM
Equity Value of Adlabs			15,717	Equivalent to Rs395 per share

Source: i-SEC Research

Financial Summary

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

	FY05	FY06	FY07E	FY08E
Operating Income (Sales)	981	1,213	2,680	4,112
of which Exports	-	-	-	-
of which Domestic	981	1,213	2,660	4,109
Operating Expenses	550	747	1,981	3,042
EBITDA	431	466	699	1,070
% margins	44.0	38.4	26.1	26.0
Depreciation & Amortisation	62	100	139	206
Gross Interest	16	16	35	99
Other Income	35	99	126	105
Recurring PBT	389	449	651	870
Add: Extraordinaries	(1)	(32)	-	-
Less: Taxes	132	136	200	267
- Current tax	120	143	169	219
- Deferred tax	12	(7)	31	48
Less: Minority Interest	13	(1)	37	47
Net Income (Reported)	242	282	414	556
Recurring Net Income	243	313	414	556

Source: Company data, i-SEC Research

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

	FY05	FY06	FY07E	FY08E
Assets				
Total Current Assets	1,234	2,353	3,639	4,166
of which cash & cash eqv.	29	254	860	791
Total Current Liabilities & Provisions	624	1,774	2,029	2,249
Net Current Assets	611	580	1,611	1,917
Investments				
of which	166	4,384	1,034	1,034
Strategic/Group	159	105	105	105
Other Marketable	7	4,279	929	929
Net Fixed Assets	843	3,199	6,420	7,480
of which				
intangibles	0	0	0	0
Capital Work-in-Progress	62	2,280	4,694	4,841
Goodwill	0.9	66.2	66.2	66.2
Total Assets	1,622	8,230	9,131	10,498
Liabilities				
Borrowings	277	4,728	5,303	6,228
Deferred Tax Liability	86	78	109	157
Minority Interest	68	0	37	84
Equity Share Capital	108	199	199	199
Face Value per share (Rs)	5	5	5	5
Reserves & Surplus*	1,084	3,224	3,482	3,829
Less: Misc. Exp. #	1	0	0	0
Net Worth	1,259	3,423	3,719	4,113
Total Liabilities	1,622	8,230	9,131	10,498

Source: Company data, i-SEC Research

*excluding revaluation reserves; # = not written off

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

	Sep-05	Dec-05	Mar-06	Jun-06
Net sales	233	262	343	511
% growth (YoY)	22.7	21.1	49.1	151
EBITDA	96	109	83	115
Margin (%)	41.3	41.6	24.2	22.6
Other income	13.7	23.1	42.9	84.3
Add: Extraordinaries	0	0	0	0
Net profit	63	72	81	121

Source: Company data, i-SEC Research

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

	FY05	FY06	FY07E	FY08E
Operating Cash flow	377	1,488	457	704
Working Capital Changes	(322)	(917)	(424)	(375)
Capital Commitments	(197)	(2,410)	(3,359)	(1,266)
Free Cash Flow	(141)	(1,839)	(3,326)	(937)
Cash flow from Investing Activities	30	(4,174)	3,476	105
Issue of Share Capital	-	92	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	133	4,451	575	925
Dividend paid	(82)	(102)	(156)	(209)
Extraordinary Items	(1)	(32)	-	-
Chg. in Cash & Bank balance	(79)	225	607	(69)

Source: Company data, i-SEC Research

Table 9: Key Ratios
(Year ending Mar 31)

	FY05	FY06	FY07E	FY08E
Per Share Data (in Rs.)				
Diluted Recurring EPS	11.3	7.8	10.4	14.0
Recurring Cash EPS	14.2	10.3	13.9	19.1
Dividend per share (DPS)	3.3	2.2	3.4	4.6
Book Value per share (BV)	58.5	86.0	93.4	103.3
Growth Ratios (%)				
Operating Income	19.4	23.6	121.0	53.4
EBITDA	26.1	8.0	49.9	53.1
Recurring Net Income	34.8	28.2	32.6	34.4
Diluted Recurring EPS	34.8	(30.8)	32.6	34.4
Diluted Recurring CEPS	33.7	(27.2)	34.2	37.9
Valuation Ratios (x)				
P/E	31.0	44.8	33.8	25.1
P/CEPS	24.7	33.9	25.3	18.3
P/BV	6.0	4.1	3.8	3.4
EV / EBITDA	18.2	30.5	25.2	17.4
EV / Operating Income	8.0	11.7	6.6	4.5
EV / Operating FCF	142.2	25.0	538.5	56.6
Operating Ratio				
Raw Material/Sales (%)	41.1	42.8	42.8	42.8
SG&A/Sales (%)	11.2	18.1	8.9	6.4
Other Income / PBT (%)	9.1	22.0	19.4	12.1
Effective Tax Rate (%)	34.1	30.7	30.7	30.7
NWC / Total Assets (%)	37.7	7.0	17.6	18.3
Inventory Turnover (days)	13.0	76	547	654
Receivables (days)	128.5	142.2	96.8	94.0
Payables (days)	77.7	75.8	52.3	62.6
D/E Ratio (x)	0.3	1.4	1.5	1.6
Return/Profitability Ratio (%)				
Recurring Net Income Margins	23.9	23.8	14.7	13.2
RoCE	27.4	9.4	7.9	9.9
RoNW	20.5	13.3	11.6	14.2
Dividend Payout Ratio	29.6	28.7	33.0	33.0
Dividend Yield	1.0	0.6	1.0	1.3
EBITDA Margins	44.0	38.4	26.1	26.0

Source: Company data, i-SEC Research

The information and opinions in this report have been prepared by ICICI Securities Limited (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. Non-rated 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 affiliates, including the analysts who have issued this report, may, on the date of this report and from time to time, have long or short positions in, and buy or sell the securities of the companies mentioned herein or engage in any other transaction involving such securities and earn brokerage or compensation or act as advisor or have other potential conflict of interest with respect to company/ies mentioned herein or inconsistent with any recommendation and related information and opinions. ICICI Securities and affiliates may seek to provide or have engaged in providing corporate finance, investment banking or other advisory services in a merger or specific transaction to the companies referred to in this report, as on the date of this report or in the past. 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. This publication is disseminated in the United States jointly by ICICI Securities and ICICI Securities Inc, which is a US registered broker dealer. ICICI Securities Inc accepts responsibility for its contents accordingly, though its accuracy and completeness cannot be guaranteed. Any person receiving this report and wishing to effect a transaction in any security discussed herein must do so through ICICI Securities Inc.
