January 18, 2018

Buy

Zee Entertainment Enterprises

Industry: Media | Industry View: Positive

LKP Since 1948

Result Update

Super Ad growth offsets subscription de-growth, Maintain BUY

Q3 bottomline below expectations

Zee's topline in Q3 grew by 12.1% despite domestic and international subscription revenues posting weak performances at a blended decline of 15.5% yoy. Excluding the sports business and the two acquisitions done over the past quarters, they would have grown at ~7%. Domestic advertising revenues got back into business by growing at 26% yoy and excluding the sports business grew at 30%. ₹400 mn related with 25 year celebrations and brand refreshment, release of three films in the quarter (two Hindi and one Marathi), increase in original programming hours, advancement of Zee Cine Awards impacted margins, still which came in at 32.4%. In Q2, Zee gained market share on Hindi GEC front (#1 non sport player with a market share of 18.3%, gaining 200 bps), while it remained either #1 or #2 in all the regional businesses. Lower other income, higher tax rate at 41% (including dividend tax) and forex fluctuations led to PAT decline of 45% on qoq basis and a growth of 26.3% yoy at ₹3.2 bn, while PAT adjusted for one off exceptional items came in at ₹3.6 bn, a growth of 10.2% yoy.

Ad revenues rampant after a gap of two quarters, signals strengthening scenario in the ad business

Zee's domestic advertisement revenues in Q2 came in at 26% yoy on a like to like basis as the GST and DeMon woos are behind them. This growth indicates a decent growth across the verticals of the Ad business. One of the biggest advertisers' volumes grew by 11% which contributed significantly to Zee's ad business revenues. Hindi GEC became the #1 non-sports channel with a 200bps growth in the viewership market share at 18.3%. Dominance in the regional space, mainly in Marathi (>50 % market share), newly acquired Bhojpuri channel Big Ganga & Oriya along with resilience in the Bangla (2nd), Telugu(1st), Tamil (3rd with an improved market share at ~17%) and Kannada (2nd) markets will further provide a traction in the ad revenues growth. Furthermore, market share will receive traction from higher spends coming on the movie basket (mainly Hindi and Marathi) by Zee. Zee is expected to further raise its investments in those genres and regions where it is lacking currently, like Kerala and Punjab markets where it lacks presence as stated by the management. Higher emphasis on online business through addition of Zee5, a new platform for online content to be launched in February along with Ozee will take care of the OTT domain. With new original content coming on the online platform, Zee will become a formidable force in the OTT industry. The company has also increased the number of Original Programming Hours at close to ~30 hours from 27.5 hours qoq and intends to take it up to 32 hours by FY18 end. This can lift up the ad revenue growth to the targeted rate. On the back of these levers, we believe Zee would post better than industry growth at 15%/18%/16% in FY18E/19E/20E on the ad revenue front given the above mentioned factors.

Subscription revenues to remain soft in FY18E, to improve FY19 onwards on digitization and new tariff regime

Zee's domestic subscription revenues in the quarter witnessed a fall of 15.5% yoy. The decline was due to delay in finalizing and renegotiation of contracts with distributors. As these issues get resolved in the coming quarters, this business is expected to get back into the groove. Going forward the hopes of monetization of Phase III and implementation of Phase IV of digitization are strong. With continued expansion of DTH, we see a stable growth in subscription revenues in FY19E and a higher growth in FY20E. Implementation of new tariff regime (albeit with a delay) may result into some more hiccups in Q4 and may be in Q1 FY19E

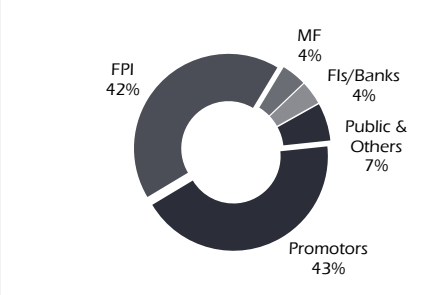
Stock Data

Current Market Price (₹)	591
Target Price (₹)	678
Potential upside (%)	15
Reuters	ZEE.BO
Bloomberg	Z IN
FV (₹)	1
Market Cap Full (₹ bn)	572
52-Week Range (₹)	619 / 465

What's Changed

12 month Price Target (₹)	From 589 to 678
FY2018E EPS (₹)	From 16.2 to 15.0
FY2019E EPS (₹)	From 19.6 to 19.2
FY2020E EPS (₹)	22.6

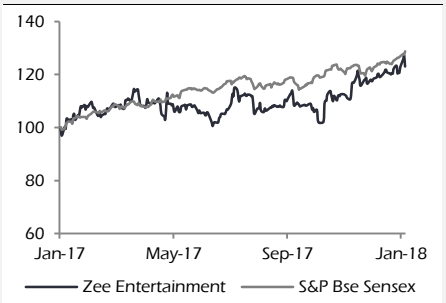
Shareholding Pattern



Fiscal YE

YE Mar	FY17	FY18E	FY19E	FY20E
Revenues(₹ mn)	64,341	67,592	77,878	89,328
EBITDA (%)	29.9%	32.0%	32.7%	33.1%
PAT (%)	18.9%	21.3%	23.6%	24.3%
EPS (₹)	12.7	15.0	19.2	22.6
EPS growth (%)	32.1%	18.4%	27.7%	17.9%
P/E (x)	46.6	39.4	30.8	26.1
P/B(x)	8.5	7.3	6.3	5.4
EV/EBITDA (x)	28.9	25.9	22.0	18.9
ROCE(%)	21.9%	21.9%	23.1%	23.8%
ROE(%)	18.3%	18.6%	20.3%	20.5%
Dividend yield (%)	0.6%	0.7%	0.9%	1.1%

Relative Price Performance



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as well, as against the management's expectations of a lower teen growth in FY18E full year (YTD de-growth has been 15%). Finalization of some new contracts with the MSOs may result into catch up revenues on and off in Q4, though we believe that it will be difficult for Zee to achieve the targeted growth in FY18E. However, it is expected to be a long term positive as it may bring transparency and structural change in industry dynamics and may provide higher financial benefits to broadcasters. This coupled with digitization will bring radical reforms within the industry value chain. On the international revenues front, new content may help Zee to offset the issues in Middle East and Bangladesh.

Management maintains strong outlook on margins despite various cost levers

Despite various cost heads moving up, the company reported 32.4% margins in Q3. Going forward, better content performance, increasing regional market share, tight cost control at the sales and distribution levels, turnaround of the loss making Zee Tamil, & TV and music businesses in FY19 may lead to superior margins. Higher subscription revenues from FY19E and increasing original programming hours may lead to higher market share and thus margins, offsetting the costs related with increase in programming hours, launch of Zee5, possible entry into Kerala markets and recent launch of two Telugu channels. Positive levers for margins may allow the company to invest more into digital, regional and movies content. We now expect 32%/32.7%/33.1% EBITDA margins in FY18E/FY19E/FY 20E respectively.

Financial Highlights

All fig in ₹ mn	Q3 FY18	Q2 FY18	% qoq	Q3 FY17	% yoy
Net Sales	18,381	15,820	16.2%	16,392	12.1%
Operating expenses	6729	5789	16.2%	7035	-4.3%
Employee cost	1,534	1,814	-15.4%	1,419	8.1%
Other expenses	4,171	3,306	26.2%	2,780	50.0%
EBITDA	5,947	4,911	21.1%	5,158	15.3%
% margins	32.4%	31.0%	130 bps	31.5%	90 bps
Depreciation	504.5	411.0	22.7%	249.0	102.6%
EBIT	5,442	4,500	20.9%	4,909	10.9%
Other income	480	2,031	-76.3%	525	-8.4%
Interest	24	3	742.9%	90	-73.8%
Exceptional Items	419	1,210	N/A	(713)	N/A
PBT	5,480	7,739	-29.2%	4,630	18.4%
Tax	2,260	1,832	23.4%	2,080	8.6%
Profit After Tax	3,220.3	5,907.0	-45.5%	2,550.1	26.3%
Adjusted PAT	3639.5	4696.6	-22.5%	3304.1	10.2%

Outlook and valuation

We anticipate a good growth in Zee's ad revenue growth as the DeMon negativity and GST pangs are more or less behind the industry and a broad based sectoral spending on advertising has been witnessed in the quarter. Market share gains have already taken place on the Hindi GEC front, regional channels, RBN and 9X acquisitions, newly launched channels, rising original programming hours and the movies basket (Marathi and Hindi) continue their excellence. Even internationally, the revenues are expected to move well on new content. This will enable the ad revenues to grow at a decent pace. Innovation in the form of new OTT channel Zee5 which would be launched in February would open an altogether new stream of revenues which is the buzz word currently. Possible entry into new market like Kerala will be an additional lever to the business. Subscription revenues may continue with their negative stint in Q4 as well as the delay in distribution deals and contracts may continue further. However, once it gets finalized, this business vertical will continue to get trigger from digitization (albeit with a delay) and the long term positives from the new tariff regulations. Margin guidance above 30% is heartening and we believe this to be quite achievable despite investments in new businesses and geographies. Robust FCF and stable dividend policy will allow the company to be a secular growth story. We have slightly reduced our FY18E and FY19E estimates on softness and uncertainty in the subscription business and management's higher tax rate guidance of 40-42%(due to dividend tax) for FY18E. We roll over to FY 20 and assign a 30x multiple to value to the company. We maintain **BUY** on the stock with a rolled over TP of **₹678**. Key concerns on the stock are 1). The proliferation of digital diaspora, which may eat into TV revenues. 2). Further delay in the tariff order implementation and execution glitches which it may face. 3). Competition coming up from the launch of Hindi GEC by Discovery and entry of Viacom 18 in Tamil markets.

Financials

Income statement

YE Mar (₹ mn)	FY17	FY18E	FY19E	FY20E
Total Revenues	**64,341**	**67,592**	**77,878**	**89,328**
Operating cost	27,825	25,009	29,204	33,498
Employee Cost	6,043	6,759	7,632	8,576
Other Exp	11,204	14,194	15,576	17,687
EBITDA	**19,269**	**21,630**	**25,466**	**29,568**
EBITDA Margin (%)	29.9%	32.0%	32.7%	33.1%
Other income	2240	4500	4900	5300
Depreciation	1,152	1,599	1,773	2,053
Interest	1372	500	700	900
PBT	**18,985**	**24,030**	**27,894**	**31,915**
PBT Margin(%)	29.5%	35.6%	35.8%	35.7%
Tax	6,805	9,612	9,484	10,213
Adj PAT	**12,180**	**14,418**	**18,410**	**21,702**
Adj PAT Margins (%)	18.9%	21.3%	23.6%	24.3%
Exceptional items	10029.4	672.8	0.0	0.0
PAT	**22,209**	**15,091**	**18,410**	**21,702**
PAT Margin (%)	34.5%	22.3%	23.6%	24.3%

Key Ratios

YE Mar	FY17	FY18E	FY19E	FY20E
Per Share Data (₹)				
Adj. EPS	12.7	15.0	19.2	22.6
CEPS	13.9	16.7	21.0	24.7
BVPS	69.3	80.7	94.2	110.2
DPS	3.7	4.4	5.6	6.6
Growth Ratios(%)				
Total revenues	10.7%	5.1%	15.2%	14.7%
EBITDA	27.3%	12.2%	17.7%	16.1%
PAT	32.1%	18.4%	27.7%	17.9%
EPS Growth	32.1%	18.4%	27.7%	17.9%
Valuation Ratios (x)				
PE	46.6	39.4	30.8	26.1
P/CEPS	42.6	35.4	28.1	23.9
P/BV	8.5	7.3	6.3	5.4
EV/Sales	8.7	8.3	7.2	6.3
EV/EBITDA	28.9	25.9	22.0	18.9
Operating Ratios (Days)				
Inventory days	95.6	105.0	110.0	112.0
Recievable Days	74.1	75.0	78.0	80.0
Payables day	27.7	27.0	25.0	23.0
Net Debt/Equity (x)	(0.15)	(0.08)	(0.07)	(0.07)
Profitability Ratios (%)				
ROCE	21.9%	21.9%	23.1%	23.8%
ROE	18.3%	18.6%	20.3%	20.5%
Dividend payout	29.3%	29.3%	29.3%	29.3%
Dividend yield	0.6%	0.7%	0.9%	1.1%

Source: Company, LKP Research

Balance sheet

YE Mar (₹ mn)	FY17	FY18E	FY19E	FY20E
EQUITY AND LIABILITIES				
Shareholder's funds				
Share capital	960	960	960	960
Reserves and surplus	65,607	76,481	89,506	104,860
Total networth	**66,567**	**77,441**	**90,466**	**105,820**
Non current liabilities				
Long term borrowings & provis	15,261	13,261	11,261	9,261
Deferred tax liabilities	11	11	11	11
Other long term liabilities	767	570	600	700
Current liabilities				
Current liabilities and provisions	4980	5090	5424	5719
Other current liabilities	12770	13170	13570	13970
Total equity and liabilities	**100,366**	**109,553**	**121,342**	**135,491**
ASSETS				
Net block	5,031	5,432	5,659	5,606
Capital work in progress	1,270	1,970	2,670	4,070
Long term investments	2,714	7,714	10,714	13,714
Long term loans and advances	5,834	6,184	6,534	6,934
Other non current assets	253	594	594	594
Total non current assets	19,427	26,219	30,496	35,243
Current assets				
Inventories	16,844	19,444	23,470	27,410
Trade receivables	13,059	13,889	16,642	19,579
Cash and cash bank	25,116	19,781	17,213	16,438
Investments	11,868	15,868	18,868	21,868
Short term loans and advances	1,541	1,541	1,541	1,541
Other current assets	12,511	12,811	13,111	13,411
Total current assets	80,939	83,334	90,846	100,248
Total Assets	**100,366**	**109,553**	**121,342**	**135,491**

Cash Flow

YE Mar (₹ mn)	FY17	FY18E	FY19E	FY20E
PBT	16,780	24,030	27,894	31,915
Depreciation	1,152	1,599	1,773	2,053
Interest	73	500	700	900
Chng in working capital	(5,670)	(3,220)	(6,345)	(6,482)
Tax paid	(6,810)	(9,612)	(9,484)	(10,213)
Other operating activities	1,165	0	0	0
Cash flow from operations (a)	**6,690**	**13,970**	**14,537**	**18,173**
Capital expenditure	(2,704)	(2,700)	(2,700)	(3,400)
Chng in investments	(2,586)	(9,000)	(6,000)	(6,000)
Other investing activities	19,258	0	0	0
Cash flow from investing (b)	**13,968**	**(11,700)**	**(8,700)**	**(9,400)**
Free cash flow (a+b)	**20,658**	**2,270**	**5,837**	**8,773**
Inc/dec in borrowings	0	(2,888)	(2,320)	(2,300)
Dividend paid (incl. tax)	(4,065)	(4,217)	(5,385)	(6,348)
Other financing activities	0	0	0	0
Interest paid	(73)	(500)	(700)	(900)
Cash flow from financing (c)	**(4,138)**	**(7,605)**	**(8,405)**	**(9,548)**
Net chng in cash (a+b+c)	**16,520**	**(5,335)**	**(2,568)**	**(775)**
Closing cash & cash equivalents	**25,116**	**19,781**	**17,213**	**16,438**

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