May 11, 2018

Outperformer

Zee Entertainment Enterprises

Industry: Media | Industry View: Positive

Result Update

Advertising growth to sustain

Q4 bottomline below expectations on higher tax

Zee's topline in Q4 grew by 12.9% despite domestic and international subscription revenues posting weak performances they dropped by 2% yoy in the quarter (adjusted for sports business, they grew by 11.8% in the year). Domestic advertising revenues adjusted for sports business sustained its performance in line with Q3 by growing at 25% yoy in Q4 and 18.7% in the year. Release of two Marathi films in the quarter (10 during the year in Hindi, Marathi and Punjabi), increase in original programming hours, launch costs related with Zee5 launch led to some pressure on margins, which were about 310 bps/140 bps down qoq/yoy at 29.3%. In Q4, Zee gained market share on Hindi GEC front (#1 non sport player with a market share of 18.5%, gaining 20 bps qoq), while it remained either #1 or #2 in all the regional businesses. Higher tax rate at 42% (including dividend tax from its foreign subsidiaries) and finance costs led to adjusted PAT decline of 45% on yoy basis and ₹1.3 bn, while reported PAT fell by 83.7% yoy

Ad revenues growth broad based and sustaining momentum

Zee's domestic advertisement revenues in Q4 came in at 25% 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. Hindi GEC became the #1 non-sports channel with a 200bps growth in the viewership market share at 18.3%, growing 20 bps qoq. Dominance in the regional space, mainly in Marathi (>50 % market share), newly acquired Bhojpuri channel Big Ganga (now Zee Ganga) & Oriya channel (Zee Sarthak) along with resilience in the Bangla (2nd), Telugu (close 2nd), Tamil (3rd with an improved market share) and Kannada (2nd) markets will further provide a traction in the ad revenues growth. Furthermore, market share will receive a 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 the Kerala and Punjab markets where it lacks presence as the management sited. Higher emphasis on online business through addition of Zee5 (with >1 lakh hours of content), a new platform for online content which was launched in February should take care of the OTT domain. With new original content coming on the online platform, Zee shall be able to mark its strong presence in the OTT industry. The company has also increased the number of Original Programming Hours at close to ~30-32 hours from 27 hours yoy. This can lift up the ad revenue growth to the targeted rate. On the back of these levers, we believe Zee to post better than industry growth at 14%/16% in FY19E/20E on the ad revenue front.

Subscription business remains under a cloud of uncertainty…

Zee's domestic subscription revenues in the quarter witnessed a fall of 10.3% in FY18. The decline was due to delay in finalizing and renegotiation of contracts with distributors in the earlier quarters. As these issues got somewhat resolved in the last quarters, the fall was controlled at just 2% drop in Q4 as compared with 14-15% declines in the previous quarters of the year. Going forward the hopes of monetization of Phase III and implementation of Phase IV of digitization are strong yet uncertain about the timeline. The new tariff order by TRAI will decide the fate of the industry and the extent to which subscription revenues will grow for the broadcasters. On the international revenues front, new content may help Zee to offset the issues in Middle East and Bangladesh. In line with this uncertainty, we have reduced our estimates for this business by about 300 bps for both FY19E and FY20E.

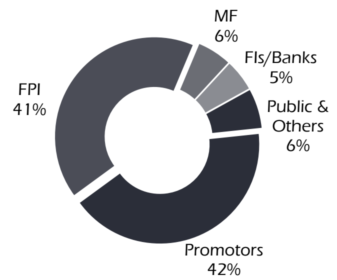
Stock Data

Current Market Price (₹)	589
Target Price (₹)	642
Potential upside (%)	9
Reuters	ZEE.BO
Bloomberg	Z IN
FV (₹)	1
Market Cap Full (₹ bn)	565
52-Week Range (₹)	619 / 477

What's Changed

12 month Price Target (₹)	From 678 to 642
FY2019E EPS (₹)	From 19.2 to 18.6
FY2020E EPS (₹)	From 22.6 to 21

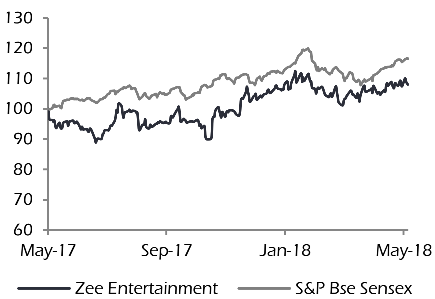
Shareholding Pattern



Fiscal YE

YE Mar	FY17	FY18	FY19E	FY20E
Revenues(₹ mn)	64,341	66,857	79,796	91,546
EBITDA (%)	29.9%	31.1%	32.2%	32.4%
PAT (%)	18.9%	20.2%	22.4%	22.4%
EPS (₹)	12.7	14.0	18.6	21.4
EPS growth (%)	32.1%	10.7%	32.3%	15.1%
P/E (x)	46.4	41.9	31.7	27.5
P/B(x)	8.5	7.5	6.4	5.5
EV/EBITDA (x)	28.8	27.0	21.7	18.7
ROCE (%)	21.1%	21.4%	24.1%	24.8%
ROE (%)	18.2%	17.8%	20.2%	20.0%
Dividend yield (%)	0.6%	0.7%	0.9%	1.1%

Relative Price Performance



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Margin growth expected, but lower than earlier expectations

On the back of various cost heads moving up, the company reported 29.3% margins in Q4, which was slightly below our expectations. Going forward, better content performance, increasing viewership market share, tight cost control at the sales and distribution levels, growth in movies and increasing ad spend from its customer verticals in FY19 may lead to sustenance of margins. Higher subscription revenues from FY19E would act as a bonus. Costs related with increase in programming hours, higher investments in Zee5, and movies basket, possible entry into Kerala markets will exert pressure on the margins thus putting some brakes on the margin growth. Hence we now expect 32.2%/32.4% EBITDA margins in FY19E/FY 20E respectively.

Financial Highlights

All fig in ₹ mn	Q4 FY18	Q3 FY18	% qoq	Q4 FY17	% yoy
Net Sales	3,878	18,381	-78.9%	15,275	-74.6%
Operating expenses	6893	3224	113.8%	6527	5.6%
Employee cost	1,638	1,534	6.8%	1,593	2.9%
Other expenses	3,660	4,171	-12.3%	2,474	48.0%
EBITDA	5,061	5,947	-14.9%	4,683	8.1%
% margins	29.3%	32.4%	(310 bps)	30.7%	(140 bps)
Depreciation	594.4	504.5	17.8%	316.3	87.9%
EBIT	4,467	5,442	-17.9%	4,366	2.3%
Other income	881	480	83.4%	549	60.4%
Interest	1,274	24	5300.0%	1,122	13.6%
Exceptional Items	(1,035)	419	N/A	11,764	N/A
PBT	5,109	5,480	-6.8%	15,558	-67.2%
Tax	2,805	2,260	24.2%	1,464	91.6%
Profit After Tax	2,303.5	3,220.3	-28.5%	14,093.9	-83.7%
Adjusted PAT	1268.5	3639.5	-65.1%	2329.9	-45.6%

Outlook and valuation

We anticipate a good growth in Zee's ad revenue growth as the DeMon negativity and GST pangs are 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 was 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 little growth at least in first half of FY19 despite low base due to the delay in distribution deals and digitization implementation of Phase III and IV. Margin guidance above 30% is heartening and we believe this to be quite achievable despite investments in new businesses and geographies, albeit at a lower pace. Robust FCF and stable dividend policy will allow the company to be a secular growth story. We have slightly reduced our FY19E and FY20E estimates on softness and uncertainty in the subscription business. We have **OUTPERFORMER** rating on the stock with a reduced TP of ₹642 (@ 30x FY20E earnings). 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). Higher than expected cost escalation associated with digital business.

Financials

Income statement

YE Mar (₹ mn)	FY17	FY18	FY19E	FY20E
Total Revenues	**64,341**	**66,857**	**79,796**	**91,546**
Operating cost	27,825	25,275	29,764	34,330
Employee Cost	6,043	6,656	7,820	8,788
Other Exp	11,204	14,164	16,518	18,767
EBITDA	**19,269**	**20,762**	**25,694**	**29,661**
EBITDA Margin(%)	29.9%	31.1%	32.2%	32.4%
Other income	2240	4404	4900	5300
Depreciation	1,152	1,821	1,899	2,053
Interest	1372	1448	1650	1780
PBT	**18,985**	**21,897**	**27,045**	**31,128**
PBT Margin(%)	29.5%	32.8%	33.9%	34.0%
Tax	6,805	8,409	9,195	10,584
Adj PAT	**12,180**	**13,488**	**17,850**	**20,545**
Adj PAT Margins (%)	18.9%	20.2%	22.4%	22.4%
Exceptional items	10029.4	1289.0	0.0	0.0
PAT	**22,209**	**14,777**	**17,850**	**20,545**
PAT Margin (%)	34.5%	22.1%	22.4%	22.4%

Key Ratios

YE Mar	FY17	FY18P	FY19E	FY20E
Per Share Data (₹)				
Adj. EPS	12.7	14.0	18.6	21.4
CEPS	13.9	15.9	20.6	23.5
BVPS	69.7	78.9	92.1	107.2
DPS	3.7	4.1	5.4	6.3
Growth Ratios (%)				
Total revenues	10.7%	3.9%	19.4%	14.7%
EBITDA	27.3%	7.7%	23.8%	15.4%
PAT	32.1%	10.7%	32.3%	15.1%
EPS Growth	32.1%	10.7%	32.3%	15.1%
Valuation Ratios (x)				
PE	46.4	41.9	31.7	27.5
P/CEPS	42.4	36.9	28.6	25.0
P/BV	8.5	7.5	6.4	5.5
EV/Sales	8.6	8.4	7.0	6.1
EV/EBITDA	28.8	27.0	21.7	18.7
Operating Ratios (Days)				
Inventory days	96.2	143.5	150.0	155.0
Recievable Days	70.4	83.9	82.0	80.0
Payables day	47.3	62.8	70.0	75.0
Net Debt/Equity (x)	(0.16)	(0.06)	(0.08)	(0.09)
Profitability Ratios (%)				
ROCE	21.1%	21.4%	24.1%	24.8%
ROE	18.2%	17.8%	20.2%	20.0%
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	FY18	FY19E	FY20E
EQUITY AND LIABILITIES				
Shareholder's funds				
Share capital	960	960	960	960
Reserves and surplus	65,954	74,799	87,427	101,963
Total networth	**66,914**	**75,759**	**88,387**	**102,923**
Non current liabilities				
Long term borrowings and prov.	15,261	11,443	9,443	7,443
Deferred tax liabilities	11	254	254	254
Other long term liabilities	3,713	901	600	700
Current liabilities				
Current liabilities and provisions	8,432	11,579	15,393	18,901
Other current liabilities	8,250	11,612	12,012	12,412
Total equity and liabilities	**102,581**	**111,549**	**126,090**	**142,633**
ASSETS				
Net block	4,871	6,005	5,311	5,258
Capital work in progress	1,270	781	1,481	2,881
Long term investments	2,714	3,148	6,148	9,148
Long term loans and advances	6,391	7,025	7,375	7,775
Other non current assets	1,730	1,352	594	594
Total non current assets	21,301	25,650	28,247	32,995
Current assets				
Inventories	16,962	26,278	32,793	38,876
Trade receivables	12,418	15,365	17,927	20,065
Cash and cash bank	26,133	16,117	16,571	16,845
Investments	11,868	13,695	16,695	19,695
Short term loans and advances	1,541	2,428	1,541	1,541
Other current assets	12,346	12,016	12,316	12,616
Total current assets	81,268	85,899	97,843	109,638
Total Assets	**102,581**	**111,549**	**126,090**	**142,633**

Cash Flow

YE Mar (₹ mn)	FY17	FY18P	FY19E	FY20E
PBT	16,780	21,897	27,045	31,128
Depreciation	1,152	1,821	1,899	2,053
Interest	73	1,448	1,650	1,780
Chng in working capital	(5,670)	(6,310)	(4,276)	(4,614)
Tax paid	(6,810)	(8,409)	(9,195)	(10,584)
Other operating activities	1,165	(3,638)	795	0
Cash flow from operations (a)	**6,690**	**6,809**	**17,918**	**19,764**
Capital expenditure	(2,704)	(1,510)	(2,700)	(3,400)
Chng in investments	(2,586)	(2,261)	(6,000)	(6,000)
Other investing activities	19,258	0	0	0
Cash flow from investing (b)	**13,968**	**(3,771)**	**(8,700)**	**(9,400)**
Free cash flow (a+b)	**20,658**	**3,037**	**9,218**	**10,364**
Inc/dec in borrowings	0	(6,643)	(1,893)	(2,300)
Dividend paid (incl. tax)	(4,065)	(3,945)	(5,221)	(6,009)
Other financing activities	0	0	0	0
Interest paid	(73)	(1,448)	(1,650)	(1,780)
Cash flow from financing (c)	**(4,138)**	**(12,036)**	**(8,764)**	**(10,089)**
Net chng in cash (a+b+c)	**16,520**	**(8,998)**	**454**	**274**
Closing cash & cash equivalents	**25,116**	**16,117**	**16,571**	**16,845**

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