

Buy

Zee Entertainment

Industry: Media

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Momentum continues...

Q2 topline above expectations on growth across board, bottomline inline

Zee's topline in Q2 FY19 grew by 24.9% yoy as both advertising revenues as well as domestic subscription revenues grew strongly. Advertising revenues grew by 23% yoy and 5.6% qoq continuing with the trend observed in the last three quarters. This is a result of heavy advertising spends from the corporates and success of its channel portfolio. Subscription revenues were robust at 26% growth in the domestic markets on early closure of some contracts and Phase III monetization. Reduction in operating costs despite launch of Zee5 in Q4 (from 37.7% in Q1 as a % of sales to 36.8% in Q2) has led to strong margin performance at 34.2% up 230 bps qoq and 320 bps yoy. Even the other expenses and advertising costs as a % of sales along with employee costs have reduced, thus leading to superior margin performance despite original programming hours inching up across the board. In Q1, Zee gained market share on Hindi GEC front (#1 non sport player with a market share of 19.9%, a growth of 70 bps qoq from 19.2%), while it remained either #1 or #2 in all the regional businesses apart from Tamil (a close #3). Higher depreciation led by increased movie inventory and investments in digital as well as TV content and lower other income somewhat restricted bottomline growth which adjusted for one off in the form of cash coming in from the sale of sports business last year same quarter was down by 13.2% yoy at ₹ 4.1 bn.

Advertising revenues to grow higher than industry as dominance persists

Zee's domestic advertisement revenues growth in Q1 came in at 23.3% yoy. This is a decent growth across the verticals of the Ad business. Hindi GEC continued to be the #1 non-sports channel with more than a percentage growth in the viewership market share at 19.9% yoy, growing 70 bps qoq. Dominance in the regional space, mainly in Marathi (>50 % market share), newly achieved leadership in Bangla market, Bhojpuri channel Big Ganga (now Zee Ganga) & Oriya channel (Zee Sarthak) along with resilience in Telugu(close 2nd), Tamil (3rd with an improved market share) and Kannada (2nd) markets will further provide a traction in the ad revenues growth. The company is about to enter Kerala markets through its Malayalam GEC Zee Keralam in December. 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 add further in its investments into channel as well as movie content. The company has also increased the number of Original Programming Hours at close to ~30-32 hours from 27 hours yoy average. FMCG, Automobile, Telecom and e-commerce verticals have been increasing their ad spending off late, mainly in the e-commerce space now with an ongoing intense battle. Despite advertising revenues having grown at an average of 21%, management expects some moderation in it on high base of H2 last year. Industry is expected to grow at 10-12%, while Zee expects to grow at higher teens. We have projected 18%/16% growth for Zee's ad business for FY19E/20E.

Potential for digital business remains immense

Post the launch of Zee5 in February, it has gained #2 spot among all the digital platforms in India. In September, the company reported a growth of 190% in the number of Monthly Active Users (MAU) over April, at 41.3 mn. During the same period, video views grew by 340% and videos viewed per user doubled. Zee charges ₹ 99/per month per user, while users spend average 31 minutes per day on Zee5. The company also targets to launch 150 exclusive movies across languages over the next twelve months. Zee5 will also launch content from various foreign countries dubbed in multiple Indian languages. The growth trajectory shown by Zee5 is creditable as it has happened without any telco contracts. We expect this business to add strong revenue stream shortly and turn profitable in coming 1-2 years.

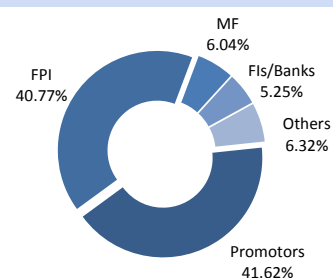
Stock Data

Current Market Price (₹)	459
12 month Price Target (₹)	573
Potential upside (%)	25
Reuters / Bloomberg	ZEE.BO / Z IN
BSE Code / NSE Symbol	505537 / ZEEL
FV (₹)	1
Market Cap Full (₹ bn)	452
52-Week Range (₹)	410 / 619

What's Changed

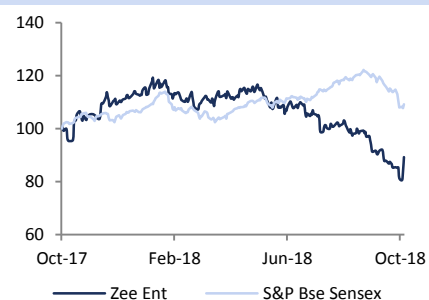
12 month Price Target (₹)	From 632 to 573
FY2019E EPS (₹)	From 17.7 to 16.9
FY2020E EPS (₹)	From 21.1 to 19.1

Shareholding Pattern



YE Mar	FY 17	FY18	FY19E	FY20E
Revenues(₹ mn)	64,341	66,857	81,729	94,069
EBITDA (%)	29.9%	31.1%	33.0%	32.4%
PAT (%)	18.9%	20.2%	19.8%	19.5%
EPS (₹)	12.7	14.0	16.9	19.1
EPS growth (%)	32.1%	10.7%	20.1%	13.3%
P/E (x)	36.2	32.7	27.2	24.0
P/B(x)	6.6	5.8	5.1	4.4
EV/EBITDA (x)	22.3	21.0	16.1	14.2
ROCE (%)	21.1%	21.5%	24.2%	23.9%
ROE (%)	18.2%	17.8%	18.6%	18.3%
Dividend yield (%)	0.8%	0.9%	1.1%	1.2%

Relative Price Performance



Subscription business takes us by surprise, though Q2 growth is not sustainable

Zee's domestic subscription revenues in the quarter witnessed a growth of 26% in Q2 FY19. The growth was in fact driven by monetization of Phase III implementation and some contracts fructifying earlier than expected. The new tariff order by TRAI will come into play from January 2019 and is expected to be profitable to the entire value chain including the broadcasters. Going forward the dividends arising from implementation of Phase III and IV of digitization will continue to pay rich dividends. On the international revenues front (1.9% growth in Q2 and 6.9% de-growth in Q1), new content may help Zee to somewhat offset the issues in Middle East and Bangladesh, but we expect a lower single digit growth. However, we believe Q2 growth is not sustainable as we have seen some lumpiness in revenues coming from preponement of contracts materializing. Hence we have maintained our subscription revenues growth at 12%/14% for FY19E/20E respectively.

Financial Highlights

All fig in ₹ mn	Q2 FY19	Q1 FY19	% qoq	Q2 FY18	% yoy
Net Sales	19,759	17,720	11.5%	15,820	24.9%
Operating expenses	7263	6683	8.7%	5789	25.5%
Employee cost	1,687	1,714	-1.6%	1,814	-7.0%
Other expenses	4,051	3,666	10.5%	3,306	22.5%
EBITDA	6,758	5,657	19.5%	4,911	37.6%
% margins	34.2%	31.9%	230 bps	31.0%	320 bps
Depreciation	588.4	576.4	2.1%	411.0	43.2%
EBIT	6,169	5,080	21.4%	4,500	37.1%
Other income	589	498	18.5%	2,031	-71.0%
Interest	55	53	3.0%	3	1846.4%
Exceptional Items	219	196	11.7%	1,210	-81.9%
PBT	6,485	5,329	21.7%	7,739	-16.2%
Tax	2,624	2,071	26.7%	1,832	43.3%
Profit After Tax	3,860.9	3,258.2	18.5%	5,907.0	-34.6%
Adjusted PAT	4079.7	3454.1	18.1%	4696.6	-13.1%

Outlook and valuation

We anticipate good growth in Zee's ad revenue growth as 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 ad revenues to grow at a decent pace in the 18-20% range for full year. In line with the stupendous performance shown by OTT channel Zee5 which was just launched in February would open an altogether new stream of revenues with its heavy investment in original content over the next 12 months. Entry into new market like Kerala will be an additional lever to the business. Subscription revenues will be driven by implementation of digitization which has started to pick up pace across the country. We believe the company can easily achieve their conservative margin guidance of ~30% (34.2% in Q2). However, we believe the 34% margins are an aberration as heavy investments in Zee5 content in India and its launch in North America may pull down the margins from Q2 levels. Robust FCF and stable dividend policy will allow the company to be a secular growth story. We have slightly reduced our margins and thereon our FY 19E and FY 20E estimates slightly on higher depreciation (stemming from movie inventory), higher Zee5 content costs, launch costs in Kerala and lower other income. We have **BUY** rating on the stock (@ 30x FY 20E earnings), with a reduced TP of ₹ 573. Key concerns on the stock are 1). The proliferation of digital diaspora, which may eat into TV revenues. 2). Higher than expected cost escalation associated with digital business.

Financials

Income statement

YE Mar (₹ mn)	FY 17	FY 18	FY 19E	FY 20E
Total Revenues	64,341	66,857	81,729	94,069
Operating cost	27,825	25,275	30,485	35,276
Employee Cost	6,043	6,656	7,356	9,031
Other Exp	11,204	14,164	16,918	19,284
EBITDA	19,269	20,762	26,971	30,478
EBITDA Margin(%)	29.9%	31.1%	33.0%	32.4%
Other income	2,240	4,404	2,000	2,000
Depreciation	1,152	1,821	2,452	2,660
Interest	1,372	1,448	400	700
PBT	18,985	21,897	26,118	29,118
PBT Margin(%)	29.5%	32.8%	32.0%	31.0%
Tax	6,805	8,409	9,925	10,774
Adj PAT	12,180	13,488	16,193	18,345
Adj PAT Margins (%)	18.9%	20.2%	19.8%	19.5%
Exceptional items	10029.4	1289.0	0.0	0.0
PAT	22,209	14,777	16,193	18,345
PAT Margin (%)	34.5%	22.1%	19.8%	19.5%

Key Ratios

YE Mar	FY 17	FY 18	FY 19E	FY 20E
Per Share Data (₹)				
Adj. EPS	12.7	14.0	16.9	19.1
CEPS	13.9	15.9	19.4	21.9
BVPS	69.7	78.9	90.8	104.4
DPS	3.7	4.1	4.9	5.6
Growth Ratios (%)				
Total revenues	10.7%	3.9%	22.2%	15.1%
EBITDA	27.3%	7.7%	29.9%	13.0%
PAT	32.1%	10.7%	20.1%	13.3%
EPS Growth	32.1%	10.7%	20.1%	13.3%
Valuation Ratios (x)				
PE	36.2	32.7	27.2	24.0
P/CEPS	33.1	28.8	23.6	21.0
P/BV	6.6	5.8	5.1	4.4
EV/Sales	6.7	6.5	5.3	4.6
EV/EBITDA	22.3	21.0	16.1	14.2
Operating Ratios (Days)				
Inventory days	96.2	143.5	152.0	160.0
Receivable Days	70.4	83.9	88.0	90.0
Payables day	47.3	62.8	64.0	66.0
Net Debt/Equity (x)	-0.16	-0.06	-0.08	-0.07
Profitability Ratios (%)				
ROCE	21.1%	21.5%	24.2%	23.9%
ROE	18.2%	17.8%	18.6%	18.3%
Dividend payout	29.3%	29.3%	29.3%	29.3%
Dividend yield	0.8%	0.9%	1.1%	1.2%

Source: Company, LKP Research

Balance sheet

YE Mar (₹ mn)	FY 17	FY 18	FY 19E	FY 20E
EQUITY AND LIABILITIES				
Shareholder's funds				
Share capital	960	960	960	960
Reserves and surplus	65,954	74,799	86,256	99,235
Total network	66,914	75,759	87,216	1,00,195
Non current liabilities				
Long term borrowings and provisions	15,261	11,443	13,443	15,443
Deferred tax liabilities	11	-	-	-
Other long term liabilities	3,713	901	600	700
Current liabilities				
Current liabilities and provisions	8,432	11,579	14,421	17,100
Other current liabilities	8,250	11,614	12,014	12,414
Total equity and liabilities	1,02,581	1,11,297	1,27,693	1,45,851
ASSETS				
Net block	4,871	6,005	6,553	6,893
Capital work in progress	1,270	780	980	1,380
Long term investments	2,714	3,150	5,150	8,150
Long term loans and advances	6,391	7,025	6,675	6,475
Other non current assets	1,730	1,098	594	594
Total non current assets	21,301	25,397	27,291	30,831
Current assets				
Inventories	16,962	26,278	34,035	41,236
Trade receivables	12,418	15,365	19,705	23,195
Cash and cash bank	26,133	16,117	20,111	22,237
Investments	11,868	13,695	12,695	14,195
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	1,00,403	1,15,020
Total Assets	1,02,581	1,11,297	1,27,693	1,45,851

Cash Flow

YE Mar (₹ mn)	FY 17	FY 18	FY 19E	FY 20E
PBT	29,009	23,187	26,118	29,118
Depreciation	1,152	1,821	2,452	2,660
Interest	101	101	400	700
Chng in working capital	-5,670	-8,551	-8,269	-7,912
Tax paid	-6,810	-8,295	-9,925	-10,774
Other operating activities	-10,376	-1,705	0	0
Cash flow from operations (a)	7,406	5,544	17,635	13,793
Capital expenditure	-2,260	-1,698	-3,200	-3,400
Chng in investments	-2,586	-1,843	-1,000	-4,500
Other investing activities	18,814	-6,956	0	0
Cash flow from investing (b)	13,968	-10,497	-4,200	-7,900
Free cash flow (a+b)	21,374	-4,953	13,435	5,893
Inc/dec in borrowings	0	-2,937	2,552	2,300
Dividend paid (incl. tax)	-2,607	-2,399	-4,737	-5,366
Other financing activities	-1,458	-5,465	0	0
Interest paid	-73	-101	-400	-700
Cash flow from financing (c)	-4,138	-10,902	-2,584	-3,766
Net chng in cash (a+b+c)	17,236	-15,855	10,851	2,127
Closing cash & cash equivalents	25,115	9,260	20,111	22,237

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