Zee Entertainment

3QFY17 Result Update

Best ever margin, rich valuations

Sector: Media

CMP: ₹ 480

Recommendation: Hold

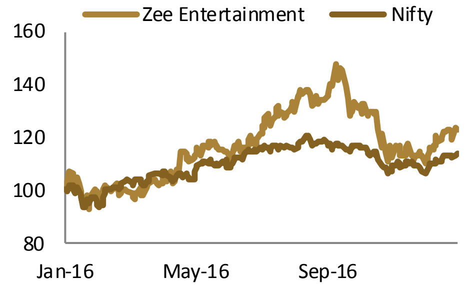
Market statistics

Current stock price (₹)	480
Shares O/S (cr.)	96.0
Mcap (₹ cr)	46,063
52W H/L (₹)	589/350
6m avg. volume	22,93,000
Bloomberg	Z.IN

Shareholding pattern

Promoters	43.07
Domestic Institution	4.33
Foreign Institution	46.61
Non-institution	5.99
of which more than 1%	
Oppenheimer Developing Markets Fund	*6.97*
Government of Singapore	*1.49*

ZEEL vs Nifty



Capital efficiency & valuations

Particulars	FY16	FY17E	FY18E
RoE (%)	18.0	22.3	24.4
EPS (₹)	11.0	13.8	15.9
CEPS (₹)	11.9	14.9	17.0
P/E (x)	34.9	38.4	33.4
P/BV (x)	5.9	9.0	7.5
EV/EBITDA (x)	23.9	25.5	22.4
Income growth (%)	19.1	12.4	6.4
EBITDA growth (%)	20.4	30.9	11.6
PAT growth (%)	8.9	26.3	14.8

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Zee Entertainment Enterprises' Q3FY17 revenue and recurring EBITDA exceeded our estimates by 1.7%/18.5% respectively. Key positives - advertisement growth of 1.4% YoY on a base of 26.8%, 15% YoY growth in domestic subscription even after the effect of demonetisation. EBITDA margin at 31.5% improved by 450bps YoY, up 261bps QoQ as the company did not spend for content this quarter. Monetization of Phase 3 digitalisation being pushed back, the company still believes that it can grow its subscription revenues by low double-digit YoY. Zee is however richly priced and we believe there could be some headwinds like tapering advertisement growth on back of high base, pricing pressure on the bouquet (ex-sports portfolio), weakness in ratings at GEC coupled with intensified competition. We maintain our Hold rating on the stock.

Subscription growth boosts revenues; margins improve QoQ on low content costs. Advertisement revenues increased 1.4% YoY (55-60% of advertisement revenue comes from FMCG sector). This is remarkable given the base of last year and the effect of demonetization for couple of months in the quarter. Domestic subscription revenues increased 15% YoY, while international revenues grew 8.4% YoY. After this spurt in EBITDA margins, we expect EBITDA margin to be higher for FY17 (compared to FY16). EBITDA was up 20% YoY, however PAT (excluding Fair value of preference shares routed through P&L) was higher by 19% YoY on account of better margins. The key properties on the Sports channels bouquet during the quarter included telecast of Zimbabwe vs Sri Lanka cricket series, South Africa vs Australia vs Pakistan vs West Indies cricket series.

Conference call takeaways: 1) **Advertisement growth:** TV industry advertisement revenue is expected to grow 10-12% during CY17E/FY18E (FMCG, consumer durable and E-commerce companies are main drivers), while Zee is expected to do better than industry. ZEE is expected to grow higher than the industry average in CY17 on account of better market share and ratings, 2) **Programming content**: Zee TV has 24 hours of original programming content per week. Going ahead, it will stay at these levels. Similarly, &TV's programming content will increase to 30 hours (currently 22 hours), 3) **Phase 3 subscription revenues**: Zee will take 18-24 months after digitisation of Phase 3 and 4 markets to achieve ARPU levels of Phase 1 and 2 markets. ZEEL is expecting domestic subscriptions to grow at mid-teens for FY17E, while international subscriptions would grow at single digits (in US$)

BARC ratings: With rural data coming, on account of BARC ratings, the company believes Zee TV will be back to No. 2 position with BARC ratings. On a like-to-like basis Zee Entertainment saw a higher-than-industry growth rate in Advertisement spends (which was primarily on account of rate hikes, since inventory is capped). BARC rating includes rural data from week 41 (i.e., 2015). With this, BARC India, which reported about 55mn households representing C&S universe of 0.1mn+, expanded its reach to 153.5mn TV households, representing all India and all modes of signal. Of this 77.5mn are urban TV households and 76mn are rural TV households. Zee is strong in the rural markets and slowly will see its market share move up post inclusion of rural data.

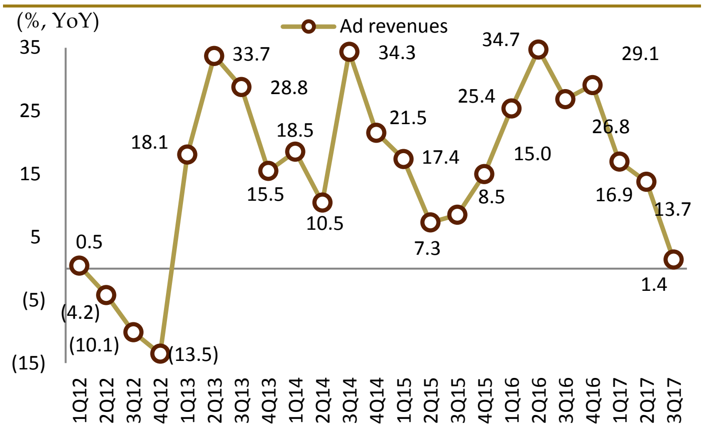
Valuations and risks. Zee is well positioned to gain from the ongoing digitalization of cable network. The growth in subscription revenue will ensure enough cash flows for Zee to invest in new channels, which will further fuel growth for the medium-to-long term. Zee is however richly priced. We are positive on the business model but believe there could be some headwinds like tapering advertisement growth on back of high base, pricing pressure on the bouquet (ex-sports portfolio), weakness in ratings at GEC coupled with intensified competition. Hence, we maintain our recommendation on Zee Entertainment at Hold.

Exhibit 1: Quarterly details

₹ mn	3QFY16	2QFY17	3QFY17	QoQ (%)	YoY (%)	Comments
Revenues	**15,951**	**16,954**	**16,391**	**(3.3)**	**2.8**	TV industry advertisement revenue is expected to grow at 10-12% during CY17E/FY18E
- Operating costs	11,649	12,062	11,233	(6.9)	(3.6)	
EBITDA	**4,302**	**4,892**	**5,158**	**5.4**	**19.9**	
EBITDA margin (%)	**27.0**	**28.9**	**31.5**	**261bps**	**450bps**	FY17E EBITDA margin is expected at 29-30%. Over long-term, EBITDA margins could be slightly above 28-29%
- Interest expense	45	86	90	5.5	102.7	
- Depreciation	201	336	249	(25.9)	23.8	
+ Other income, net (incl forex)	290	432	525	21.3	81.0	
PBT	**4,346**	**4,903**	**5,343**	**9.0**	**22.9**	
- Taxes	1,602	1,634	2,081	27.3	29.9	
Effective tax rate (%)	36.9	33.3	38.9	561bps	208bps	FY17 tax rate would be 34-35%.
PAT	**2,744**	**3,269**	**3,263**	**(0.2)**	**18.9**	
Minority interests	(6)	56	41	NA	NA	
Consolidated profits	2,750	3,213	3,222	0.3	17.1	PAT increase of 19% YoY was driven by better margins.
Reported PAT	2,750	2,384	2,508	5.2	(8.8)	

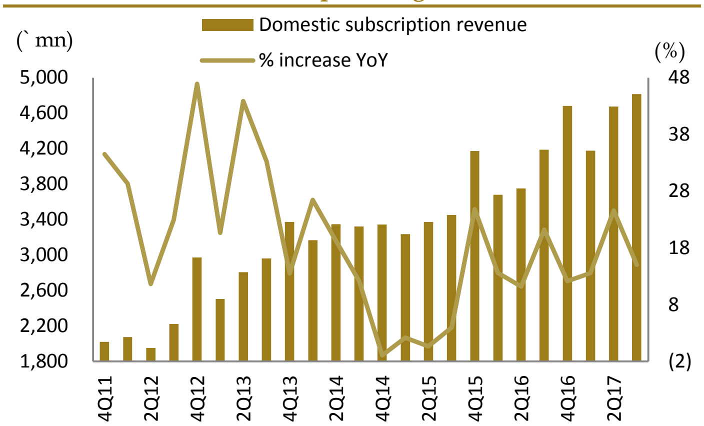
Source: Company, 1Q16, 1Q17 numbers are as per IND-AS

Exhibit 2: Ad revenues were down due to demonetisation



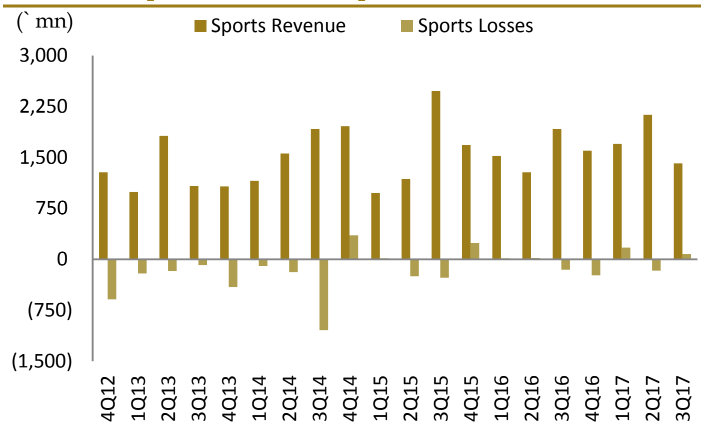
Source: Company, Trust

Exhibit 3: Domestic subscription to grow in 15% in FY17E



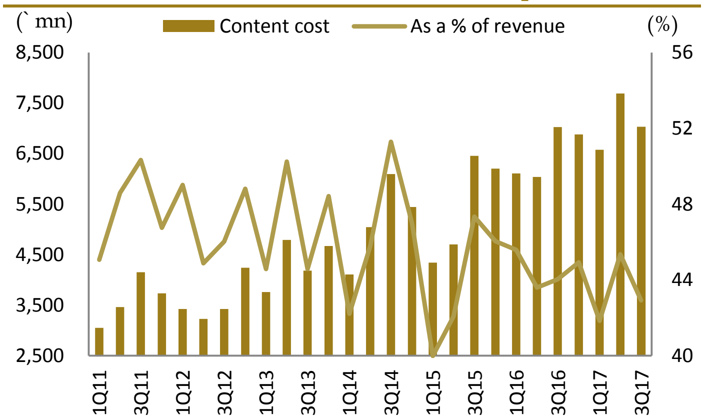
Source: Company, Trust

Exhibit 4: Sports EBITDA was positive



Source: Company, Trust

Exhibit 5: Content cost was lower-than-our-expectation



Source: Company, Trust

Zee to gain most incase of relaxation in ad-cap minutes

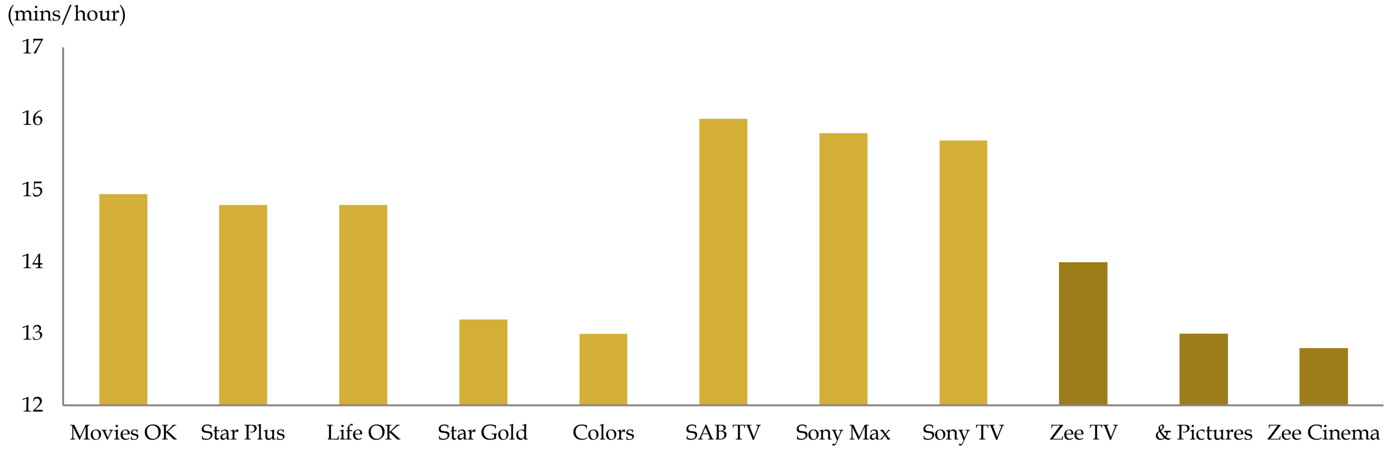
The Telecom Regulatory Authority of India (TRAI) released its first report on the average duration of advertising amongst pay channels. Data reveals that Zee is amongst the most disciplined broadcasters with prime-time advertising (alongwith self-promotional content) being under 14 mins/hour.

In the Hindi GEC/movie genres, among the large broadcasters, Star India and Multi Screen Media (which runs Sony TV), have prime-time ad times of ~15/16 mins/hour, while ZEEL's advertising measures ~12-14 mins/hour.

In the regional space, viz. Marathi, Bengali, Kannada and Telugu, ZEEL's advertising is under 14 mins/hour. This puts the company in good position, incase TRAI imposes advertising restrictions of 12 mins/hour (as discussed in our Sector Thematic, and is now sub-judice). In such a case where competitors are currently running greater advertising, the rate increases needed to offset the reduced inventory will be lower for ZEEL, thus allowing it to reap benefits of re-pricing of advertisements.

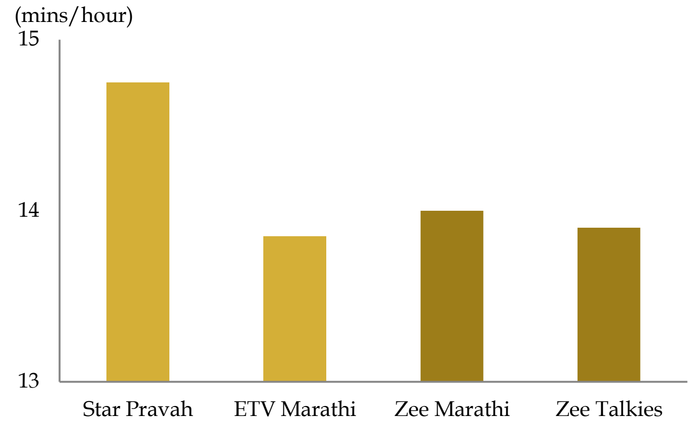
Alternatively, if TRAI doesn't impose an advertisement time restriction, ZEEL, on account of its lower advertisement time/hour, is in a position to increase inventory and hence achieve faster advertisement revenue growth than peers.

Exhibit 6: Hindi general entertainment channels (GECs) and movies : prime-time (7PM-10PM) advertising (mins/hour)



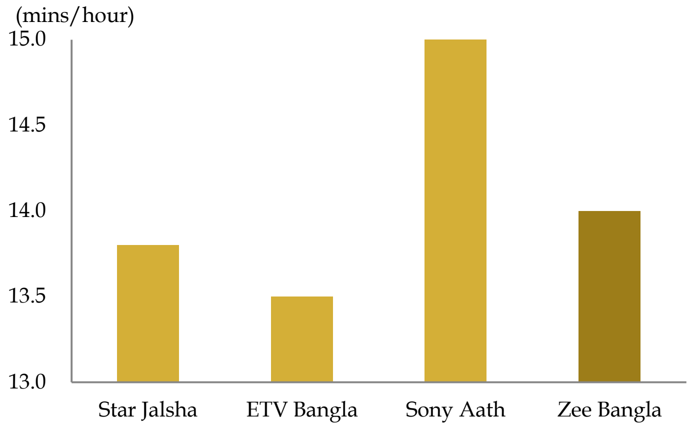
Source: Company, Trust

Exhibit 7: Marathi channels: Prime time advertising



Source: Company, Trust

Exhibit 8: Bengali channels: Prime time advertising



Source: Company, Trust

Financials

Income Statement (₹ mn)

Year End-March	FY15	FY16	FY17E	FY18E	FY19E
Revenues	**49,144**	**58,514**	**65,786**	**70,026**	**80,530**
Op. Expenses	36,606	43,418	46,023	47,975	55,099
EBITDA	**12,538**	**15,096**	**19,763**	**22,052**	**25,431**
Other Income	2,278	2,016	2,191	2,300	2,800
Depreciation	673	840	1,095	1,136	1,301
EBIT	**14,142**	**16,271**	**20,859**	**23,216**	**26,930**
Interest	103	123	351	230	207
PBT	**14,040**	**16,148**	**20,508**	**22,986**	**26,723**
Tax	4,284	5,528	7,097	7,585	8,819
PAT	**9,756**	**10,620**	**13,411**	**15,400**	**17,904**
Minority	20	(22)	(150)	(164)	(164)
Ex. Ordinary items	-	331	2,675	-	-
Adj Pat	**9,776**	**10,268**	**10,587**	**15,237**	**17,741**

Key Parameters

Year End-March	FY15	FY16	FY17E	FY18E	FY19E
Per share (₹)					
EPS	10.2	11.0	13.8	15.9	18.5
CEPS	10.9	11.9	14.9	17.0	19.8
BVPS	57.8	64.9	58.9	71.0	85.1
DPS	2.3	2.3	2.8	3.3	3.8
Payout (%)	25.9	23.9	23.3	24.0	23.8
Valuation (x)					
P/E	33.5	34.9	38.4	33.4	28.7
P/BV	5.9	5.9	9.0	7.5	6.2
EV/EBITDA	25.5	23.9	25.5	22.4	19.2
Dividend Yield (%)	0.7	0.6	0.5	0.6	0.7
Return ratio (%)					
EBIDTA Margin	25.5	25.8	30.0	31.5	31.6
PAT Margin	19.9	18.1	20.4	22.0	22.2
ROAE	19.0	18.0	22.3	24.4	23.7
ROACE	27.5	27.6	35.0	37.2	35.9
Leverage Ratios (x)					
Long Term D/E	0.0	0.0	0.0	0.0	0.0
Net Debt/Equity	(0.3)	(0.3)	(0.3)	(0.4)	(0.4)
Debt/EBITDA	0.0	0.0	0.0	0.0	0.0
Interest Coverage	137.8	132.3	59.5	100.9	130.1
Current ratio	3.6	3.4	3.7	4.2	4.4
Growth Ratios (%)					
Income growth	11.1	19.1	12.4	6.4	15.0
EBITDA growth	4.1	20.4	30.9	11.6	15.3
PAT growth	9.6	8.9	26.3	14.8	16.3
Turnover Ratios					
F.A Turnover x	11.3	10.1	12.0	12.2	13.6
Inventory Days	88	82	82	83	83
Debtors Days	79	83	84	85	85
Payable days	42	44	44	44	44

Balance Sheet (₹ mn)

Year End-March	FY15	FY16	FY17E	FY18E	FY19E
Equity Share Capital	960	960	960	960	961
Reserves & Surplus	54,538	61,354	68,850	80,435	93,960
Total Shareholders Fund	**55,498**	**62,314**	**69,811**	**81,396**	**94,921**
Minority Interest	4	85	85	85	85
Non- current liabilities	**249**	**308**	**147**	**184**	**321**
Long term Borrowings	12	9	9	9	9
Deferred tax liabilities	(531)	(556)	(745)	(745)	(745)
Other LT liabilities & prov	768	854	883	920	1,057
Current Liabilities	**13,776**	**15,678**	**16,644**	**17,350**	**19,926**
Short-term borrowings	-	-	-	-	-
Trade payables	4,204	5,194	5,548	5,783	6,642
Other cur liabilities & Prov	9,572	10,484	11,096	11,567	13,284
Total Liabilities	**69,527**	**78,385**	**86,687**	**99,015**	**115,253**
Assets					
Non- current Assets	**19,725**	**24,515**	**22,055**	**22,796**	**24,175**
Fixed assets	4,367	5,810	5,469	5,733	5,932
Non-current investments	9,351	12,197	9,197	9,197	9,197
Long-term loans & adv	5,629	5,913	6,669	7,099	8,163
Other non-current assets	378	594	721	767	883
Current assets	**49,802**	**53,870**	**64,631**	**76,218**	**91,078**
Current investments	8,291	7,391	7,391	7,391	7,391
Trade receivables	10,692	13,245	15,140	16,308	18,754
Inventories	11,878	13,160	14,779	15,924	18,312
Cash & bank balances	**7,365**	**9,733**	**15,606**	**24,125**	**32,280**
Short-term loans & adv	10,248	8,810	9,913	10,552	12,135
Other current assets	1,328	1,532	1,802	1,919	2,206
Total Assets	**69,527**	**78,385**	**86,686**	**99,014**	**115,253**

Cash flow Statement

Year End-March	FY15	FY16	FY17E	FY18E	FY19E
PBT	**14,040**	**16,148**	**20,508**	**22,986**	**26,723**
Depreciation	439	816	906	1,136	1,301
Interest Exp	103	123	351	230	207
Others	(37)	(272)	(2,824)	(164)	(164)
CF before W.cap	**14,545**	**16,816**	**18,941**	**24,188**	**28,068**
Inc/dec in W.cap	4,117	1,112	4,776	2,801	5,172
Op CF after W.cap	10,428	15,704	14,165	21,387	22,896
Less Taxes	4,284	5,528	7,097	7,585	8,819
Net CF From Operations	**6,144**	**10,175**	**7,068**	**13,802**	**14,077**
Inc/(dec) in F.A + CWIP	935	2,284	753	1,401	1,500
(Pur)/sale of Investments	1,726	1,946	(3,000)	-	-
Others	(103)	(123)	(351)	(230)	(207)
CF from Invst Activities	**(2,764)**	**(4,353)**	**1,896**	**(1,631)**	**(1,707)**
Loan Raised/(repaid)	(5)	(3)	-	-	-
Equity Raised	874	(923)	(0)	0	0
Dividend	2,528	2,528	3,090	3,652	4,216
CF from Fin Activities	**(1,660)**	**(3,454)**	**(3,090)**	**(3,652)**	**(4,215)**
Net inc /(dec) in cash	1,720	2,368	5,874	8,520	8,155
Op. bal of cash	5,644	7,364	9,732	15,606	24,125
Cl. balance of cash	**7,364**	**9,732**	**15,606**	**24,125**	**32,280**

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