

24 July 2019

## Zee Entertainment

*Strong subscription growth aided revenue; Buy*

Rating: **Buy**

Target Price: ₹450

Share Price: ₹379

Driven by 46.8% y/y growth in domestic subscription revenue, Zee's Q1 FY20 revenue grew 13.3% y/y to ₹20.08bn. Domestic advertising revenue grew 4.2% y/y, as 5-6% of advertising growth has been hit by the conversion of two FTA channels into pay channels. Lower other expenses due to good cost control (8.6% vs. 12.8% y/y) resulted in the margin expanding 93bps y/y to 32.9%. We cut our FY20e/FY21e EBITDA 4% and 5.5% respectively and our target multiple to 15x FY21e EBITDA (earlier valuing it at 17x FY21e EBITDA) to reflect soft ad growth and increased investment in OTT, resulting in a target of ₹450 (earlier ₹550). The promoter stake sale is a near-term catalyst.

**Q1 ad growth in-line, subscription growth surpasses expectations.** Zee's Q1 revenue grew 13.3% despite muted, 4% y/y, ad growth, primarily driven by 37% y/y growth in subscription revenue. Domestic subscription revenue grew a robust 46.8% y/y mainly driven by monetisation of Phase-III subscribers and a sharp improvement in subscription revenues in southern markets. The company has guided to mid-20's growth in domestic subscription revenue for FY20, helped by the new tariff order and partly on the conversion of two free-to-air channels into pay channels. Ad growth would be muted in Q2 and recovery is expected in H2 FY20.

**Investments in Zee5 to peak in FY20.** Investments in digital will further increase in FY20 as the company ramps up production of ZEE5 Originals and movie offerings across languages. These content investments would be complemented by marketing spend. FY20 slate of original content is building up well and the company is on track to launch more than 70 original shows and movies in six languages.

**Maintaining our Buy rating.** We now value Zee at 15x FY21e EV/EBITDA and maintain our Buy rating, with a TP of ₹450. **Risk:** Any slippage in content ratings.

Key financials (YE Mar)	FY17	FY18	FY19	FY20e	FY21e
Sales (₹ m)	64,342	66,857	79,339	87,128	95,491
Net profit (₹ m)	22,202	14,778	15,812	17,991	18,652
EPS (₹)	10.4	14.0	16.3	18.7	19.4
PE (x)	16.2	24.4	23.0	20.0	19.3
EV / EBITDA (x)	18.0	16.7	13.6	12.8	12.1
PBV (x)	5.4	4.8	4.0	3.5	3.1
RoE (%)	38.6	20.7	19.0	18.8	17.2
RoCE (%)	18.1	13.5	15.5	15.0	14.5
Dividend yield (%)	0.6	0.8	0.9	0.9	1.0
Net debt / equity (x)	-0.3	-0.2	-0.1	-0.1	-0.1

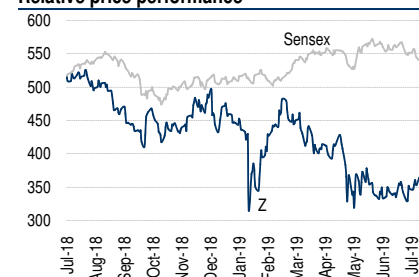
Source: Company, Anand Rathi Research Note: FY17 and FY18 figures are adjusted for the sale of the sports business

Key data	Z IN / ZEE.BO
52-week high / low	₹541 / 288
Sensex / Nifty	37848 / 11271
3-m average volume	\$66.9m
Market cap	₹365bn / \$5285.6m
Shares outstanding	960m

Shareholding pattern (%)	June'19	Mar'19	Dec'18
Promoters	35.8	38.2	41.6
- of which, Pledged	64.0	66.2	59.4
Free float	64.2	61.8	58.4
- Foreign institutions	47.1	45.0	41.5
- Domestic institutions	6.3	6.3	10.9
- Public	10.8	10.5	6.0

Estimates revision (%)	FY20e	FY21e
Revenues	(5.1)	(5.5)
EBITDA	(4.0)	(5.5)
Net profit	3.8	(2.8)

### Relative price performance



Source: Bloomberg

**Shobit Singhal**  
Research Analyst

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## Quick Glance – Financials and Valuations

**Fig 1 – Income statement (₹ m)**

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
Net revenues	64,342	66,857	79,339	87,128	95,491
Growth (%)	11	4	19	10	10
Ad revenue contri %	57.1	62.9	63.5	60.9	60.8
Direct costs	33,800.3	31,932.0	38,007.4	41,986.0	46,313.4
Gross profit	30,541.8	34,924.8	41,331.9	45,142.1	49,178.1
Gross margins %	47.5	52.2	52.1	51.8	51.5
SG&A	11,273	14,164	15,693	18,095	20,578
<b>EBITDA</b>	<b>19,269</b>	<b>20,761</b>	<b>25,639</b>	<b>27,047</b>	<b>28,600</b>
EBITDA margins (%)	29.9	31.1	32.3	31.0	30.0
- Depreciation	1,152	1,821	2,347	2,760	2,800
Other income	12,270	5,683	2,551	4,118	3,350
Interest expenses	1,372	1,448	1,304	1,115	890
PBT	29,014	23,175	24,538	27,290	28,260
Effective tax rates (%)	23.5	36.3	35.7	34.1	34.0
+ Associates / (Minorities)	-5	12	24	-	-
Net income	22,202	14,778	15,812	17,991	18,652
WANS	960	960	960	960	960
FDEPS (₹ / sh)	10.4	14.0	16.3	18.7	19.4

**Fig 3 – Cash-flow statement (₹ m)**

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
PBT	29,014	23,175	24,538	27,290	28,260
+ Non-cash items	-8,762	-785	3,263	-1,358	-550
Oper. prof. before WC	20,252	22,390	27,802	25,932	27,710
- Incr. / (decr.) in WC	-6,036	-8,551	-17,151	-10,861	-10,841
Others incl. taxes	-6,810	-8,295	-9,299	-9,299	-9,608
Operating cash-flow	7,406	5,544	1,352	5,772	7,261
- Capex (tang. + intang.)	-15,713	1,800	2,814	3,100	3,398
Free cash-flow	23,119	3,744	-1,462	2,672	3,863
Acquisitions	-113	-2,015	-	-	-
- Div. (incl. buyback & taxes)	4,065	3,834	4,734	5,427	5,577
+ Equity raised	-	-	-	-	-
+ Debt raised	-	-6,967	-4,876	-2,500	-2,500
- Fin investments	3,440	2,051	-19,793	13,507	220
- Misc. (CFI + CFF)	-1,001	-1,107	-956	-4,118	-3,350
Net cash-flow	16,502	-10,016	-3,899	-1,069	-1,084

Source: Company, Anand Rathi Research

**Fig 5 – Price movement**



Source: Bloomberg

**Fig 2 – Balance sheet (₹ m)**

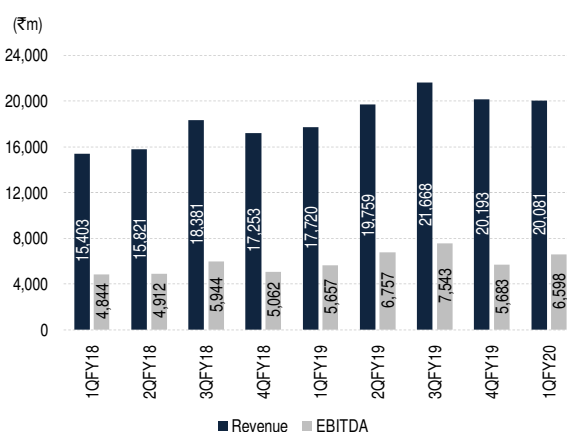
Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
Share capital	960	961	961	961	961
Net worth	66,905	75,617	89,239	1,01,804	1,14,878
Debt	19,088	15,245	11,114	8,614	6,114
Minority interest	10	142	143	143	143
DTL / (Assets)	-903	-	-	-	-
<b>Capital employed</b>	<b>85,100</b>	<b>91,004</b>	<b>1,00,496</b>	<b>1,10,561</b>	<b>1,21,135</b>
Net tangible assets	4,872	6,005	5,959	5,267	5,006
Net intangible assets	458	1,734	1,383	2,347	3,426
Goodwill	2,676	5,467	5,252	5,252	5,252
CWIP (tang. & intang.)	1,558	920	1,561	1,561	1,561
Investments (strategic)	2,714	3,148	2,740	2,740	2,740
Investments (financial)	11,868	13,695	8,576	8,576	8,576
Current assets (ex cash)	51,394	64,210	91,641	1,03,816	1,15,120
Cash	26,133	16,117	12,218	11,149	10,065
Current liabilities	16,572	20,293	28,835	30,148	30,612
Working capital	34,821	43,918	62,806	73,667	84,508
<b>Capital deployed</b>	<b>85,100</b>	<b>91,004</b>	<b>1,00,496</b>	<b>1,10,561</b>	<b>1,21,135</b>
Contingent liabilities	-	-	-	-	-

**Fig 4 – Ratio analysis**

Year-end: Mar	FY17	FY18	FY19	FY20e	FY21e
P/E (x)	16.2	24.4	23.0	20.0	19.3
EV / EBITDA (x)	18.0	16.7	13.6	12.8	12.1
EV / Sales (x)	5.3	5.2	4.4	4.0	3.6
P/B (x)	5.4	4.8	4.0	3.5	3.1
RoE (%)	38.6	20.7	19.0	18.8	17.2
RoCE (%) - after tax	18.1	13.5	15.5	15.0	14.5
RoIC (%) - after tax	29.0	21.8	20.9	18.5	17.3
DPS (₹ / sh)	2.3	2.9	3.5	3.6	3.7
Dividend yield (%)	0.6	0.8	0.9	0.9	1.0
Dividend payout (%) - incl. DDT	21.7	20.7	20.7	19.0	19.0
Net debt / equity (x)	-0.3	-0.2	-0.1	-0.1	-0.1
Receivables (days)	70	84	84	90	90
Inventory (days)	94	131	169	190	200
Payables (days)	68	91	101	90	75
CFO : PAT %	33.4	37.5	8.6	32.1	38.9

Source: Company, Anand Rathi Research

**Fig 6 – Quarterly financial performance**



Source: Company

## Result Highlights

### Q1 FY20 Results at a Glance

Fig 7 – Segment-wise results

(₹ m)	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	QoQ %	YoY%
Revenues	17,720	19,759	21,668	20,193	20,081	-0.6%	13.3%
Growth Y/Y %	15.0%	24.9%	17.9%	17.0%	13.3%	-371 bps	-173 bps
Advertisement	11,460	12,106	14,626	12,175	11,867	-2.5%	3.6%
Domestic	10,870	11,526	13,719	11,575	11,322	-2.2%	4.2%
International	590	580	907	600	545	-9.2%	-7.6%
Subscription	5,186	6,082	6,185	5,653	7,088	25.4%	36.7%
Domestic	4,252	5,093	5,192	4,696	6,240	32.9%	46.8%
International	934	989	993	957	848	-11.4%	-9.2%
Others	1,074	1,571	857	2,365	1,126	-52.4%	4.9%
Programming & Operating cost	(6,683)	(7,263)	(7,978)	(8,833)	(7,800)	-11.7%	16.7%
As % of revenues	-38%	-37%	-37%	-44%	-39%	490 bps	-113 bps
Staff cost	(1,714)	(1,687)	(1,834)	(2,015)	(2,003)	-0.6%	16.9%
As % of revenues	-15%	-14%	-13%	-17%	-17%	-33 bps	-193 bps
Selling & Other costs	(3,667)	(4,051)	(4,313)	(3,662)	(3,680)	0.5%	0.4%
As % of revenues	-21%	-21%	-20%	-18%	-18%	-19 bps	237 bps
EBITDA	5,657	6,757	7,543	5,683	6,598	16.1%	16.6%
EBITDA margins %	32%	34%	35%	28%	33%	471 bps	93 bps
Depreciation	(576)	(588)	(615)	(568)	(690)	21.5%	19.7%
EBIT	5,080	6,169	6,928	5,115	5,908	15.5%	16.3%
EBIT margins %	29%	31%	32%	25%	29%	409 bps	75 bps
Other income	285	369	1,236	661	1,718	159.9%	503.6%
Interest expense	(53)	(55)	(55)	(1,142)	(205)	-82.0%	287.7%
PBT	5,312	6,483	8,109	4,635	7,420	60.1%	39.7%
PBT margins %	30%	33%	37%	23%	37%	1400 bps	698 bps
Taxes	(2,071)	(2,624)	(2,484)	(1,494)	(2,146)	43.6%	3.6%
ETR	-39%	-40%	-31%	-32%	-29%	331 bps	1006 bps
PAT	3,241	3,859	5,625	3,141	5,275	67.9%	62.7%
PAT margins %	18.3%	19.5%	26.0%	15.6%	26.3%	1071 bps	798 bps

Source: Company, Anand Rathi Research

Fig 8 – Quarterly result (₹ m)

Year-end: Mar	Q1FY20	% Q/Q	% Y/Y	FY19	FY18	% Y/Y
Sales	20,081	(0.6)	13.3	79,339	66,857	18.7
EBITDA	6,598	16.1	16.6	25,640	20,761	23.5
EBITDA margins (%)	33	471 bps	93 bps	32	31	126 bps
EBIT	5,908	15.5	16.3	23,293	18,941	23.0
EBIT margins (%)	29	409 bps	75 bps	29	28	103 bps
PBT	7,420	60.1	39.7	24,321	20,220	20.3
Tax	(2,146)	43.6	3.6	(8,673)	(8,752)	(0.9)
Tax rate (%)	(29)	490 bps	1006 bps	(36)	(43)	762 bps
Net Income	5,298	81.1	62.6	15,673	11,480	36.5

Source: Company, Anand Rathi Research

## Conference call highlights

### Company-specific

- The company sees industry ad growth in low double-digits including sports for the current fiscal. We see Zee faring marginally better than the industry this fiscal.
- The company expects its EBITDA margin to stay around 30% in FY20 despite it being the year of peak investments from a Zee5 perspective. In our view, the rollout of mobile-only tariff plans by Netflix and of originals by Hotstar may be the reasons for the company increasing investments in Zee5 this year. We believe it may be too early to say investments in Zee5 may peak this year
- The company added that FY20 would be another year of marginal FCF growth and suggested investments in working capital may increase by ₹5bn-6bn this fiscal.
- Promoters may sign a binding agreement with a potential strategic/financial investor in a few days with regard to a stake sale. At present, promoters had one binding offer and were expecting another in a few days.
- Zee expects telco partnerships to improve; in our view, there may be progress with Jio on a partnership.

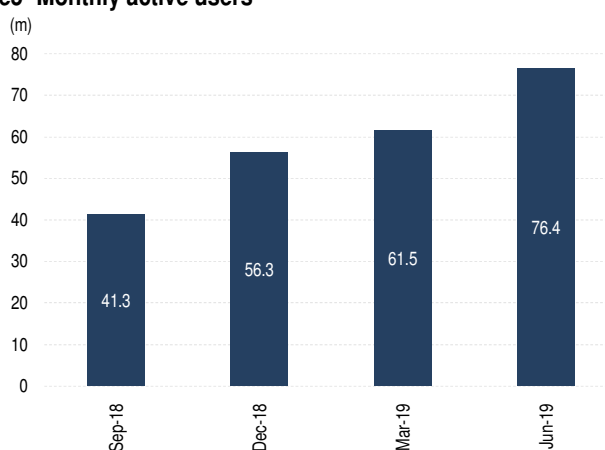
## Factsheet

**Fig 9 – Factsheet**

Year-end: Mar	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20
<b>Revenue split (%)</b>					
Advertisements	65%	61%	68%	60%	59%
Subscriptions	29%	31%	29%	28%	35%
Others	6%	8%	4%	12%	6.0%
<b>Revenue split (₹m)</b>					
Advertisements	11,460	12,106	14,626	12,175	11,867
Subscriptions	5,186	6,082	6,185	5,653	7,088
Others	1,074	1,571	857	2,365	1,126
<b>Y/Y growth (%)</b>					
Advertisements	19%	23%	22%	16%	3.6%
Subscriptions	8%	21%	23%	3%	36.7%
Others	13%	67%	-36%	83%	5.0%
<b>Advertisement revenue split (%)</b>					
Domestic revenues	95%	95%	94%	95%	95%
International revenues	5%	5%	6%	5%	5%
<b>Subscription revenue split (%)</b>					
Domestic revenues	82%	84%	84%	83%	88%
International revenues	18%	16%	16%	17%	12%
<b>Zee Sports (₹ m)</b>					
Revenues	ND	ND	ND	ND	ND
Costs	ND	ND	ND	ND	ND
EBITDA	ND	ND	ND	ND	ND
EBITDA margins (%)	ND	ND	ND	ND	ND

Source: Company

**Fig 10 – Zee5 -Monthly active users**



Source: Company

## Valuations

Zee is uniquely positioned in the media sector due to its leading position in Hindi GEC and the various sub-segments – specifically, regional content. It also secures a scarcity premium as the other two competitors are unavailable for investors in the secondary market.

We believe that the media eco-system is evolving in favour of content companies and, therefore, the ability to consistently procure and build popular content would be even more valuable in the near future. Also, advertising expenditure is expected to rise due to enhancements in the economic environment. This, however, was delayed in FY17/18 due to the de-monetisation, but growth has strongly returned in FY19.

At the CMP of ₹379, the stock trades at 12.8x and 12.1x respective FY20e and FY21e EV/EBITDA. We now value Zee at 15x FY21e EV/EBITDA (earlier valuing at 17x FY21e EBITDA) and arrive at a price target of ₹450 (earlier ₹550).

**Fig 11 – Change in estimates**

₹ m)	FY20e			FY21e		
	New	Old	Chg %	New	Old	Chg %
Revenues	87,128	91,787	(5.1)	95,491	1,01,090	(5.5)
EBITDA	27,047	28,179	(4.0)	28,600	30,276	(5.5)
EBITDA margin %	31.0	30.7	34 bps	30.0	29.9	0 bps
EBIT	24,287	25,579	(5.1)	25,800	27,476	(6.1)
EBIT margin %	27.9	27.9	1 bps	27.0	27.2	-16 bps
PBT	27,290	27,029	1.0	28,260	29,937	(5.6)
Net profit	17,991	17,325	3.8	18,652	19,189	(2.8)

Source: Anand Rathi Research

**Fig 12 – EV/EBITDA**



Source: Bloomberg, Anand Rathi Research

## Risks

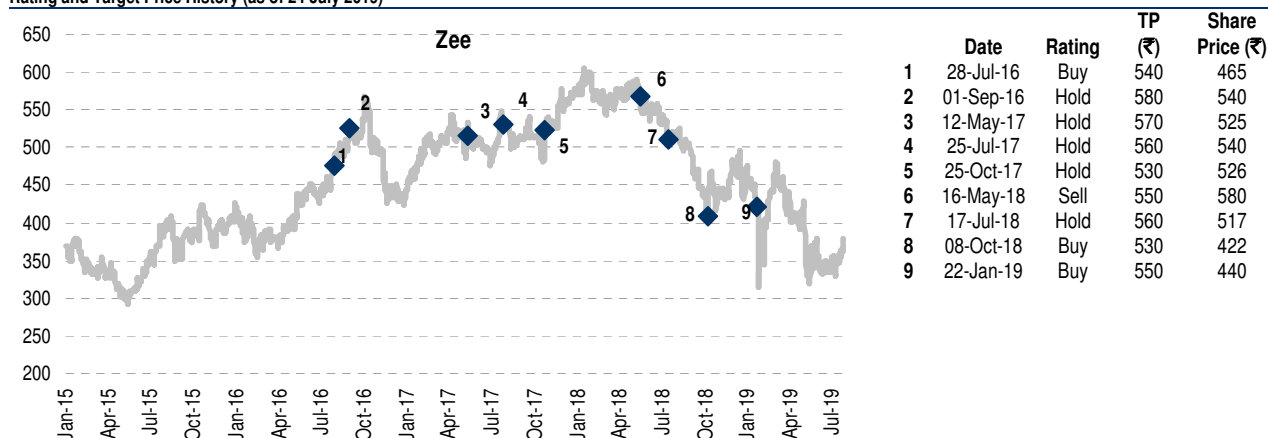
- Any loss in content rating in the flagship/leadership genres.

## Appendix

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ARSSBL registered address: 4th Floor, Silver Metropolis, Jaicoach Compound, Opposite Bimbisar Nagar, Goregaon (East), Mumbai - 400 063.  
Tel No: +91 22 4001 3700 | Fax No: +91 22 4001 3770 | CIN: U67120MH1991PLC064106.