Zee Entertainment Enterprises

Reco: Buy

Stock Update

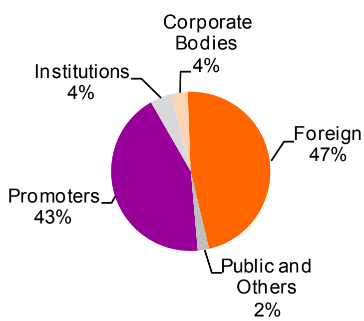
On a strong growth track; maintain Buy with revised price target of Rs580

CMP: Rs513

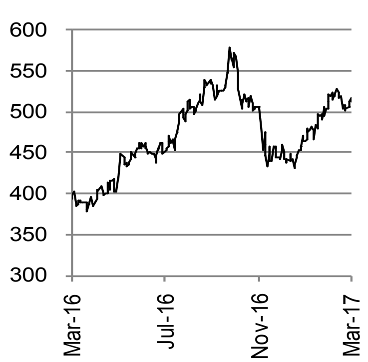
Company details

Price target:	Rs580
Market cap:	Rs49,276 cr
52-week high/low:	Rs588/373
NSE volume: (No of shares)	22.2 lakh
BSE code:	505537
NSE code:	ZEEL
Sharekhan code:	ZEEL
Free float: (No of shares)	54.7 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-1.0	12.5	-3.0	31.5
Relative to Sensex	-3.1	3.9	-3.7	11.0

We recently interacted with the management of Zee Entertainment Enterprises (ZEEL) to get an understanding about the outlook on: advertising post the demonetisation shock, targeted margin band after the exit from the loss-making Sports business and the potential impact on broadcasters under TRAI's new regulations for TV Broadcast industry.

Key points

- **Advertising revenue to return to normal by Q1FY2018, margins to be ~30% comfort range:** Though growth in advertising revenue is expected to be muted in Q4FY2017 (as the key sectors like FMCG, Telecom, Auto and e-commerce have lowered their ad spends in the wake of demonetisation), the management expects the ad revenue growth to rebound to pre-demonetisation level from Q1FY2018 onwards. FY2018 would not suffer from the adverse impact of demonetisation, as the management foresees higher ad spends from Telecom and Auto sectors, besides pent-up spends from the FMCG pack amid a host of new launches. The management remains confident of surpassing the overall industry growth in advertising revenue in future (industry level growth will be ~8-11%). On margins, the management is comfortable with the level of 30%, and will re-invest the savings from the exit in the Sports business back into the core business (likely to add 300-350BPS in FY2018).
- **Rating worries on flagship Zee channel to reduce in the next few quarters, regional portfolio continues to see traction:** In the last 3-4 months, ZEEL's flagship channel ZEE TV has witnessed a drop in its rating, which the management has attributed to change in leadership six months back (new channel head). ZEEL expects to introduce new content on ZEE TV and will do away with unviable content. The management expects programming hours to increase to 28-30 from 24.5 currently. The strategy to achieve breakeven for &TV is working well (breakeven expected in FY2018-FY2019). The programing hours for &TV will improve to 25 hours from 23 hours now (20 hours in Q3FY2017). As far as the regional channels are concerned, Marathi, Telugu, Bangla and Kannada channels are doing well, while Tamil has done fairly well with significant improvement in viewership and market share in the last 2-3 years. Sarthak TV (acquired last year) continues to maintain its leadership position in the Odisha market. With the acquisition of Big Ganga channel in Q2FY2018, ZEEL will have a leadership position in the Bhojpuri-centric region in North India (will consolidate in H2FY2018).
- **Subscription revenue expected to see full impact of Phase III digitalisation by FY2019:** The domestic subscription revenue growth is expected to be in the range of mid-teens to high-teens, whereas the international subscription revenue growth will remain flat on account of saturation in the key markets. The ZEEL management expects double-digit growth in subscription revenue in the medium term, as the benefits of phase III digitalisation will be reflected in the next 12-15 months.
- **Strong earnings momentum to be intact; maintain Buy:** ZEEL continues to be focused on five pillars to drive long-term growth. We expect the successful execution of this strategy to have a material long-term sustainable growth. In the short term, we expect the announcement of RPS redemption (cash already received) from the sale of Sports business, which will expand the return ratios besides improving its ratings, and the continued strength in the regional portfolio to justify premium valuation of ZEEL. We have introduced FY2019 estimates in this note. We continue to remain positive on ZEEL, as it is one of the key beneficiaries of the structural pan-India consumption theme. We maintain our 'Buy' rating with a revised price target of Rs580.

Valuation Rs cr

Particulars	FY15	FY16	FY17E	FY18E	FY19E
Revenues	4,883.7	5,851.5	6,439.1	7,290.1	8,380.4
EBITDA margin (%)	25.7	26.4	29.8	30.5	32.0
Adjusted net profit	977.5	904.3	1,281.0	1,476.7	1,771.6
EPS (Rs)	10.2	9.9	13.3	15.4	18.5
P/E (x)	50.4	51.8	38.4	33.4	27.8
EV/EBITDA (x)	39.6	32.1	24.6	20.7	16.9
RoE (%)	27.7	21.5	25.5	24.7	24.7
RoCE (%)	22.7	24.4	26.9	27.6	29.3

*EPS after preference dividend and excluding MTM gains/loss on preference shares
*FY17/FY18 based on IND AS

- **No major impact on ZEEL's subscription revenue if TRAI's new regulations are implemented:** TRAI has released the final regulations for the TV Broadcast industry, which include mandatory display of all channels and their rates, choice of subscription to a-la-carte channels and bouquets of channels, and separate bouquet for pay channels and free-to-air (FTA) channels. The implementation of TRAI's new regulations will empower the customers to pick and pay for only those channels that they watch. Given ZEEL's dominant presence in the Hindi and regional channels portfolio, we believe that its subscription revenue will not be impacted if the TRAI's new regulations are implemented. However, there could be some increase in cost.

- **Movies and Music to remain one of the core pillars for growth:** ZEEL is sharpening its focus on strengthening its presence in acquiring satellite movie rights and music rights, movie production, movie distribution and digital offerings (Ditto TV and OZEE). ZEEL has recently increased investments on buying satellite rights for movies, as the rates have rationalised over the past few years. ZEEL has re-entered the movie production business with a co-production model and plans to produce 10-12 movies (a mix of regional and Hindi movies) in a year, with a capital allocation of Rs150-170 crore. On the Music segment, the company is aggressively acquiring new music rights, with the company buying more than 50% of the industry-wide music rights in the last two years.

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