Zee Entertainment (ZEEENT)

ICICI direct Research

CMP: ₹ 152 | Target: ₹ 150 (-1%) | Target Period: 12 months | HOLD

July 26, 2020

Result Update

Weak quarter…further accentuated by one-offs!

Zee Entertainment's (Zee) Q4FY20 performance truly had a plot twist of a Bollywood potboiler. The washout ad revenues (~15% YoY decline) were on expected lines (economic slowdown & some *Covid-19* impact) but stupendous subscription growth of ~31% YoY was a pleasant surprise (Zee5 contribution now making the difference). **The costs, however, told a different story, with a slew of one-offs such an accelerated amortisation expenses of ₹ 259.8 crore, provision of ₹ 343 crore for doubtful debts, exceptional loss of ₹ 113.7 crore towards goodwill write-off and ₹ 383.5 crore MTM losses on overseas investments.** EBITDA loss, consequently, was at ₹ 283.9 crore with reported net loss of ₹ 766.7 crore.

Ad in FY21 to be washout; stable subscription a solace…

Zee expects the mix of macroeconomic challenges, Covid-19 shock to impact sharply with about two-third of ad revenues loss in Q1, worst case ad revenue fall of 28-30% in FY21. It expects some recovery by Q2 end aided by festive season beginning and complete availability of new programming (currently operating at ~60-70% in Hindi, ~80-90% in regionals (ex-Tamil)). We bake in ~20% decline in ad revenues, followed by ~25% growth in FY22, on a depressed base. On the subscription front, given the impact of *NTO 2 (*albeit the company does not expect it to be implemented and, hence, expects "reasonable" growth in FY21*)*, we conservatively build in overall subscription revenue CAGR of 8.5% in FY20-22E to ₹ 3390 crore.

One-offs, related party dealings paint ugly picture

We highlight that almost all the one-offs (accelerated amortisation, provision for doubtful debts and MTM losses on overseas investments) during the quarter have been attributed to Covid-19. ***That said we would have preferred them to be termed as "clean ups" and assurance of better accounting/decision making henceforth.*** Furthermore, there was auditor qualification for US$ 52.5 million letter of comfort issued to the bank for a related party, which has now defaulted and the bank has sought payment from its 100% subsidiary. **The matter is *sub judice*. While the company believes, based on legal advice, that LOC is not considered as guarantee and does not require recognition of liability, the *ugly part is no disclosure of this arrangement even in annual reports.* Furthermore, dues from Dish TV and Siti Networks cumulatively is ~₹ 815 crore (vs. ~₹ 750 crore in Q3). There remains the risk of default partly, considering their liquidity position.**

Valuation & Outlook

The near term concerns include soft ad outlook as well as impact of *NTO 2 (if it gets implemented).* The wish-list of possibly better disclosures and cash generations, is what should be looked at, apart from overall improvement in ad environment and Zee5 ramp up. Notwithstanding attractive valuations, we maintain **HOLD**, with a target price of ₹ 150/share, valuing it at 9x FY22 P/E. ***We would turn believers once we see visible changes in cash generation and more (rather better) disclosures.***

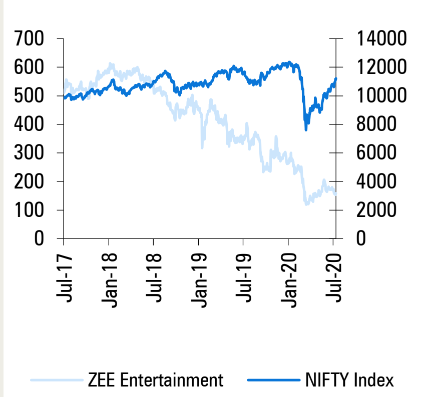
Extraordinary Together

Particulars	Amount
Market Cap (₹crore)	14,570.3
Total Debt (FY 20) (₹crore)	52.6
Cash & Inv. (FY 20) (₹crore)	1,011.5
EV (₹crore)	13,611.4
52 week H/L (₹)	405/ 114
Equity capital (₹crore)	96.1
Face value (₹)	1.0

Key Highlights

- Ad revenue fell 14.7% YoY while strong subscription growth of 31.2% was better than estimates
- We maintain HOLD, with target price of ₹ 150/share, valuing it at 9x FY22 P/E

Price Chart



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Key Financial Summary

(Year-end March)	FY18	FY19	FY20	FY21E	FY22E	CAGR FY20-FY22E
Net Sales (₹crore)	6,685.7	7,933.9	8,129.9	7,147.6	8,512.2	2.3
EBITDA (₹crore)	2,076.1	2,567.6	1,634.6	1,824.7	2,466.3	22.8
Net Profit (₹crore)	1,479.1	1,545.8	526.5	1,132.0	1,612.0	75.0
EPS (₹)	15.4	16.1	5.5	11.8	16.8	
P/E (x)	9.9	9.4	27.7	12.9	9.0	
Price / Book (x)	1.6	1.5	1.5	1.4	1.3	
EV/EBITDA (x)	5.6	4.9	8.3	7.3	5.1	
RoE (%)	15.3	15.7	16.7	10.8	14.1	
RoCE (%)	25.6	25.7	13.9	16.0	20.3	

Source: Company, ICICI Direct Research

Exhibit 1: Variance Analysis

	Q4FY20	Q4FY20E	Q4FY19	Q3FY20	YoY (%)	QoQ (%)	Comments
Revenue	1,951.1	1,772.1	2,019.3	2,048.7	-3.4	-4.8	Revenues were impacted by advertisement revenues which declined by 14.7% YoY to ₹1038.9 crore owing to the impact of conversion of FTA channels into paid, overall macroeconomic slowdown and Covid-19 led lockdown in March. The overall subscription revenues grew sharply by 31.2% YoY to ₹741.4 crore, led by strong growth 40.7% YoY in domestic subscription, driven by tailwinds of NTO and Zee5 subscription growth
Other Income	-238.0	50.0	66.1	30.9	-460.1	-871.6	Affected by ₹383.5 crore MTM losses on overseas investments
Raw Material Expenses	0.0	0.0	0.0	0.0	NA	NA	
Employee Expenses	160.4	194.9	201.5	207.5	-20.4	-22.7	
Admin & Other Expenses	585.8	177.2	173.2	237.0	238.3	147.2	
Marketing Expenses	184.1	194.9	193.0	190.8	-4.6	-3.5	
Operational Cost	1,304.6	779.7	883.3	847.6	47.7	53.9	
Other Expenses	0.0	0.0	0.0	0.0	NA	NA	
EBITDA	-283.9	425.3	568.3	565.8	-149.9	-150.2	The company reported higher operating costs mainly due to accelerated amortisation expenses of ₹278.7 crore, new channels launch and investment in Zee5. Additionally, provision of ₹343 crore for doubtful debts was made which led to operating losses
EBITDA Margin (%)	-14.5	24.0	28.1	27.6	4269 bps	4217 bps	
Depreciation	77.8	53.6	56.8	65.6	36.9	18.6	
Interest	86.4	110.0	114.2	20.0	-24.3		
Total Tax	-37.2	80.9	149.4	162.2	-124.9	-122.9	The company reported exceptional loss of ₹113.7 crore towards goodwill write-off.
PAT	-766.7	231.7	291.7	349.4	-362.8	-319.4	
Key Metrics							
Ad Revenue Growth	-14.7%	-18.4%	16.0%	-15.8%			
Domestic Subscription	40.7%	25.4%	3.9%	21.7%			
International Subscription	-15.7%	-16.0%	1.4%	-17.4%			

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

	FY21E			FY22E			
(₹Crore)	Old	New	% Change	Old	New	% Change	
Revenue	7,397.0	7,147.6	-3.4	8,709.7	8,512.2	-2.3	Bake in extended Covid-19 impact
EBITDA	2,069.7	1,824.7	-11.8	2,612.9	2,466.3	-5.6	
EBITDA Margin (%)	28.0	25.5	-245 bps	30.0	29.0	-103 bps	
PAT	1,393.4	1,132.0	-18.8	1,795.2	1,612.0	-10.2	
EPS (₹)	14.5	11.8	-18.8	18.7	16.8	-10.2	

Source: Company, ICICI Direct Research

Exhibit 3: Assumptions

			Current			Earlier	
	FY18	FY19	FY20E	FY21E	FY22E	FY21E	FY22E
Ad Revenue Growth	14%	20%	-7%	-20%	25%	-12%	21%
Domestic Subscription	-10%	17%	33%	10%	8%	10%	10%
International Subscription	-12%	-1%	-16%	-14%	23%	-20%	23%

Source: Company, ICICI Direct Research

FY20 performance highlights

Zee Entertainment's operating revenues for FY20 were at ₹ 8129.9 crore, up 2.5% YoY. Ad revenues fell 7.1% YoY to ₹ 4681.1 crore amid macroeconomic slowdown. Overall subscription revenues reported strong growth of 25% YoY to ₹ 2887.3 crore with domestic subscription revenues growing at 33.2% YoY to ₹ 2562.3 crore. International subscription revenue, however, declined 16.1% YoY to ₹ 325 crore. EBITDA came in at ₹ 1634.6 crore (down 36.3% YoY) with EBITDA margins at 20.1% YoY, down 1230 bps YoY. The company reported an exceptional loss of ₹ 284.3 crore owing to provisions and impairment of assets. Additionally, Zee reported MTM losses of 259.7 crore during FY20. Subsequently, PAT was at ₹ 526.5 crore, down 66% YoY.

Conference call highlights

- **Ad revenue decline continues; guidance of steep fall in FY21E:** The management attributed ad decline in Q4FY20 to poor macroeconomic environment, conversion of two FTA channels into paid and market share loss in some regions coupled with Covid-19 impact in March. **Market share loss (ex- GEC market share at 18.3% in Feb-March vs. 19.7% in FY19) is likely due to content not appealing to the audiences as per the management and possibly on account of FTA channels going paid, in our view.** Also, they said that ad revenue could decline sharply by two-third in Q1FY21E amid a lockdown. While ad spend from the FMCG sector is getting better post resumption of economic activities, the outlook will be given post Q2FY21E. The management was hopeful that the festive season (Q2 end onwards) will lead to a faster recovery of revenues. **Subsequently, the management guided for 28-30% fall in ad revenues for FY21E, in the worst case**

- **Subscription segment boosts revenues:** The management informed that the company reported industry leading domestic subscription growth of 33.2% in FY20. While no fresh content was telecast during lockdown, currently all GECs (except Tamil) have started broadcasting new content. The new programming run rate is at ~60-70% in Hindi and ~80-90% in regionals (ex-Tamil). Distribution platform operators (DPOs) also faced some difficulties on collection front in Q1. However, the management expressed an optimistic view and said growth momentum will continue in FY21 as well. ***The management was of the view that NTO 2.0 will not be implemented*.** While Trai has directed broadcasters to comply with new tariff order and sought bouquet details, there is no clarity on timeline of its implementation yet. The company will continue to invest in content and recovery should follow with a lag

- **Receivables from key strategic customers:** The company has trade receivables of ₹ 815.5 crore from Dish TV and Siti networks (a related party) as of FY20 end. The management said that overdue amounts have been received regularly from Dish TV in Q1FY21E as per payment plan. With respect to receivables from Siti networks, the company has provided for expected credit loss of ₹ 117.9 crore

- **Higher operating costs, one-offs hit bottomline:** The company reported higher operating costs mainly due to accelerated amortisation expenses of ₹ 259.8 crore, new channels launch and investment in Zee5. Additionally, provision of ₹ 343 crore for doubtful debts was made, which includes expected credit loss of ₹ 117.9 crore. The company also reported an exceptional loss ₹ 113.7 crore towards goodwill write-off. Also, ₹ 383.5 crore MTM losses on overseas investments hit the earnings. The company has sold these assets and has recovered 15% of amount till now. Zee has also taken inventory write off on some ad revenue driven channels considering challenge in monetisation.

- **Inventory increase due to movie rights; Zee5 investments ramp up:** The management said that the increase in inventory by ₹ 1497 crore was due to acquisition of satellite and digital rights of movies and ramp up in investment in Zee5. Zee5 recorded a global Daily Active Users (DAU) of 6 million and 63.1 million global monthly active users (MAU) in March with revenues up 60-70% during lockdown. **The management indicated that both the investments in the movie business and movie inventory will witness a decline in FY21. It also added that financials of Zee5 and detailed breakup of inventories will be shared from coming quarters**

- **The management expects no potential liability on ATL matter: There was auditor qualification for US$52.5 million letter of comfort (LOC) issued to bank for a related party which has now defaulted. The bank has sought payment from its 100% subsidiary.** The management said that in the matter regarding put option agreement between ATL Media Network (wholly owned subsidiary) and Living Entertainment Ltd (a related party), Zee Entertainment does not expect any potential liability and has not recognised the same. In the same case, LOC was issued to the bank by the company confirming its intention of capital infusion in ATL. While the bank claims the LOC is a guarantee of payment and has asked for the same, the company said LOC does not provide guarantee for payment. The matter is *sub judice* and Zee believes no liability needs to be recognised

- **Zee 4.0**: The management said the recent period was challenging given the financial headwinds faced by the promoter group. The company from now on will maintain a transparent approach with better governance. The management said Zee Entertainment is also committed towards growth and will keep a granular approach towards reporting financials and KPIs

- **Other highlights**:

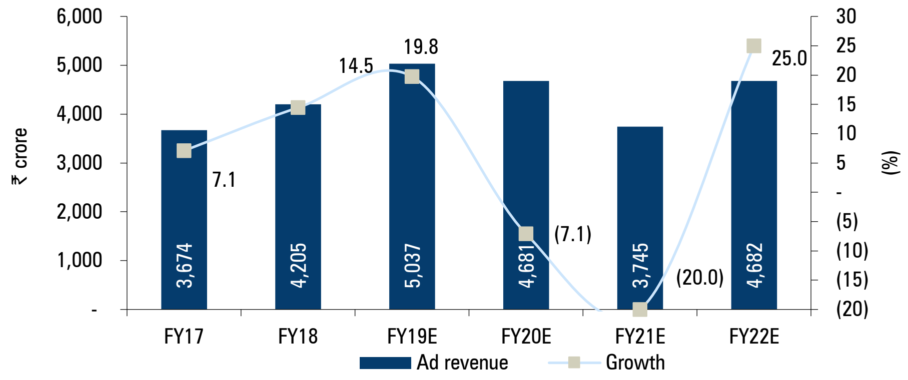
  i) Redemption of preference shares and sale of foreign investments at loss impacted the cash flows. The management guided for cash generation of at least 50% of PAT from FY22E onwards

  Ii) Cash investment in Sugarbox has been delayed till Q4FY21E

  Iii) The company is planning to sell the real estate and aviation assets

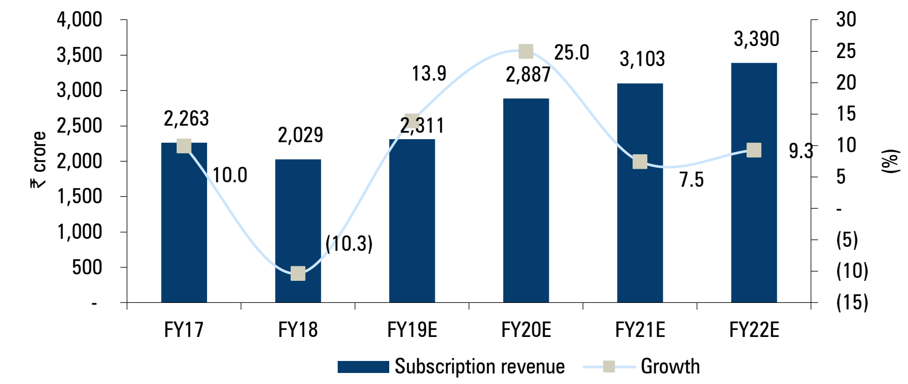
Story in charts

Exhibit 4: Ad revenue growth trend



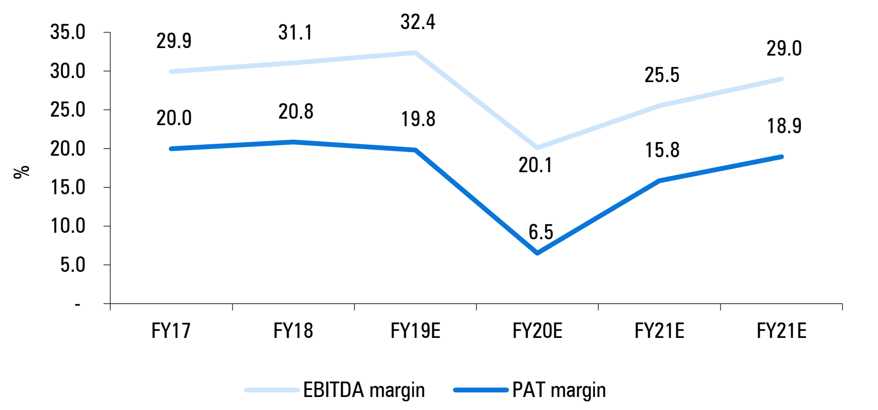
Source: Company, ICICI Direct Research

Exhibit 5: Subscription revenue growth trend



Source: Company, ICICI Direct Research

Exhibit 6: EBITDA and PAT margin trend



Source: Company, ICICI Direct Research

Financial summary

Exhibit 7: Profit and loss statement (₹ crore)

(Year-end March)	FY19	FY20	FY21E	FY22E
Total operating Income	**7,933.9**	**8,129.9**	**7,147.6**	**8,512.2**
Growth (%)	18.7	2.5	-12.1	19.1
Operational Cost	3,072.2	3,828.5	2,960.5	3,532.6
Employee Expenses	724.9	780.5	770.2	808.7
Admin & Other Expenses	870.0	1,190.7	879.6	938.6
Marketing Expenses	699.3	695.6	712.6	766.1
Total Operating Expenditure	5,366.3	6,495.3	5,322.8	6,045.9
EBITDA	**2,567.6**	**1,634.6**	**1,824.7**	**2,466.3**
Growth (%)	23.7	-36.3	11.6	35.2
Depreciation	234.7	270.6	285.9	301.3
Interest	130.4	144.9	150.0	140.0
Other Income	251.5	24.0	145.0	160.0
Exceptional Items	43.1	284.3	-	-
PBT	2,410.8	958.7	1,533.8	2,184.9
Minority Interest	0.2	(1.9)	6.0	8.0
PAT from Associates	2.4	(2.4)	2.0	2.0
Total Tax	867.3	431.7	397.9	566.9
PAT	**1,545.8**	**526.5**	**1,132.0**	**1,612.0**
Growth (%)	4.5	-65.9	115.0	42.4
Adjusted PAT	**1,573.4**	**1,661.5**	**1,132.0**	**1,612.0**
Growth (%)	12.9	5.6	-31.9	42.4
Reported EPS (₹)	**16.1**	**5.5**	**11.8**	**16.8**

Source: Company, ICICI Direct Research

Exhibit 8: Cash flow statement (₹ crore)

(Year-end March)	FY19	FY20	FY21E	FY22E
Profit after Tax	**1,545.8**	**526.5**	**1,132.0**	**1,612.0**
Add: Depreciation	234.7	270.6	285.9	301.3
Add: Interest paid	130.4	144.9	150.0	140.0
(Inc)/dec in Current Assets	-2,622.3	-822.0	97.9	-674.7
Inc/(dec) in CL and Provisions	926.5	-384.0	-333.8	338.3
Others	0.0	0.0	0.0	0.0
CF from op. activities	**215.2**	**-263.9**	**1,332.0**	**1,716.9**
(Inc)/dec in Investments	554.7	649.4	-500.0	-500.0
(Inc)/dec in Fixed Assets	-301.1	-213.8	-200.0	-200.0
Others	-132.5	58.1	1.5	1.5
CF from inv.activities	**121.1**	**493.8**	**-698.5**	**-698.5**
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Issue of Preference Shares	-413.2	-516.3	-297.5	-297.5
Inc/(Dec) in loan funds	1.1	50.6	-	-
Interest paid	130.4	144.9	150.0	140.0
Others	-444.5	-396.3	-640.0	-620.0
CF from fin. activities	**-726.1**	**-717.2**	**-787.5**	**-777.5**
Net Cash flow	-389.8	-487.4	-154.0	240.9
Opening Cash	1,611.7	1,221.8	734.5	580.5
Closing Cash	**1,221.9**	**734.5**	**580.5**	**821.4**

Source: Company, ICICI Direct Research

Exhibit 9: Balance sheet (₹ crore)

(Year-end March)	FY19	FY20	FY21E	FY22E
Liabilities				
Equity Capital	96.1	96.1	96.1	96.1
Preference Share Capital	1,111.3	595.0	297.5	0.0
Reserve and Surplus	8,827.9	9,247.9	10,039.8	11,311.9
Total Shareholders funds	10,035.2	9,938.9	10,433.4	11,407.9
Total Debt	2.0	52.6	52.6	52.6
Others	14.3	11.0	12.5	14.0
Total Liabilities	**10,051.6**	**10,002.5**	**10,498.5**	**11,474.5**
Assets				
Gross Block	1,867.7	2,156.3	2,356.3	2,556.3
Less: Acc Depreciation	908.6	1,179.2	1,465.1	1,766.5
Net Block	959.2	977.1	891.2	789.9
Capital WIP	108.3	33.4	33.4	33.4
Total Fixed Assets	1,067.4	1,010.5	924.6	823.3
Investments	1,479.7	712.1	1,212.1	1,712.1
Inventory	3,850.5	5,347.5	5,385.2	5,597.1
Debtors	1,827.4	2,084.7	2,154.1	2,332.1
Loans and Advances	1,623.4	1,323.4	1,163.5	1,385.6
Other Current Assets	1,005.5	373.2	328.1	390.8
Cash	1,221.8	734.5	580.5	821.4
Total Current Assets	9,528.6	9,863.3	9,611.3	10,527.0
Creditors	1,489.7	1,680.3	1,477.3	1,759.4
Provisions	145.1	152.6	134.2	159.8
Other current liabilities	1,120.5	538.3	425.9	456.5
Total Current Liabilities	2,755.2	2,371.3	2,037.4	2,375.7
Net Current Assets	6,773.4	7,492.0	7,573.9	8,151.3
Other non current assets	731.1	787.9	787.9	787.9
Total Assets	**10,051.6**	**10,002.5**	**10,498.5**	**11,474.5**

Source: Company, ICICI Direct Research

Exhibit 10: Key ratios (₹ crore)

(Year-end March)	FY19	FY20	FY21E	FY22E
Per share data (₹)				
EPS	16.1	5.5	11.8	16.8
Adjusted EPS	16.4	17.3	11.8	16.8
BV	104.5	103.5	108.6	118.8
DPS	3.0	0.4	3.5	3.5
Cash Per Share	9.5	12.3	15.3	18.4
Operating Ratios (%)				
EBITDA Margin	32.4	20.1	25.5	29.0
EBIT Margin	29.4	16.8	21.5	25.4
PAT Margin	19.8	20.4	15.8	18.9
Inventory days	177.1	240.1	275.0	240.0
Debtor days	84.1	93.6	110.0	100.0
Creditor days	68.5	75.4	75.4	75.4
Return Ratios (%)				
RoE	15.7	16.7	10.8	14.1
RoCE	25.7	13.9	16.0	20.3
RoIC	30.2	16.4	18.5	25.2
Valuation Ratios (x)				
P/E	9.4	27.7	12.9	9.0
EV / EBITDA	4.9	8.3	7.3	5.1
EV / Net Sales	1.6	1.7	1.9	1.5
Market Cap / Sales	1.8	1.8	2.0	1.7
Price to Book Value	1.5	1.5	1.4	1.3
Solvency Ratios				
Debt/EBITDA	0.0	0.0	0.0	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	5.1	5.0	5.6	5.1
Quick Ratio	2.7	2.1	2.3	2.1

Source: Company, ICICI Direct Research

Exhibit 11: ICICI Direct Coverage Universe (Media)

Sector / Company	CMP (₹)	TP (₹)	Rating	M Cap (₹cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
					FY19	FY20	FY21E	FY19	FY20	FY21E	FY19	FY20	FY21E	FY19	FY20	FY21E	FY19	FY20	FY21E
Inox Leisure	240	255	Hold	2,461	13.0	1.5	-17.8	18.4	164.3	NM	8.3	4.3	12.3	13.2	19.6	10.0	10.6	14.2	2.4
PVR	1,103	1,085	Hold	5,153	39.2	5.3	-61.9	28.1	207.5	NM	10.9	5.7	11.6	14.7	13.8	8.5	11.5	14.8	1.8
Sun TV	376	490	Buy	14,804	36.4	35.1	37.1	10.3	10.7	10.1	5.3	6.1	5.6	38.5	31.2	29.7	25.9	24.2	22.6
TV Today	205	240	Buy	1,225	22.0	23.4	22.6	9.3	8.8	9.1	4.7	5.0	4.9	30.4	22.7	24.7	19.3	14.6	16.0
ZEE Ent.	152	150	Hold	14,569	16.1	5.5	11.8	9.4	27.7	12.9	4.9	8.3	7.3	25.6	25.7	13.9	15.3	15.7	16.7

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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