

Announces merger with SPNI...

About the stock: Zee Entertainment (Zee) is one of the largest listed media companies in India, which owns and operates a bouquet of 49 TV channels across 11 languages and also an OTT app *Zee5*.

- The company's TV network share dropped to 17% in Q1FY22 vs. 18.9% in Q4FY21 due to lockdown disruption and weak performance in categories such as Hindi GEC, Tamil and Marathi

Event

- Zee and Sony Pictures Networks India (SPNI) announced an exclusive, non-binding term sheet to merge both companies. The merged entity will have 75 channels, two OTT platforms and ~25%+ TV viewership market share. The companies will have 90 days for due diligence with expected completion timeline of six to eight months, post statutory approvals
- The resultant merger ratio is expected be 47.07% of the merged entity to be held by Zee shareholder and 52.93% by SPNI. The company also said that indicative merger ratio would have been 61.25% in favour of Zee shareholders, albeit it changed with proposed infusion of growth capital by SPNI (such that SPNI's cash balance is at ~US\$1.575 bn at time of closing). This implies, combined entity was valued at ₹ 50,207 crore.
- The Goenka's (current Zee promoter) stake shall remain at 4% in the combined entity, will incremental 2% to be given by SPNI for non-compete. They will have right to take their stake up to 20% (mode not yet announced)
- Punit Goenka will remain as MD and CEO for five years. This, we believe, will keep the contention of shareholders' activism likely in near term

What should investors do? We expect the merger announcement and shareholders' activism to be a battle in the near term, which could impact management focus on operations as well as lead to stock price volatility. The recovery in market share in Hindi GEC and Marathi/Tamil will be also key to overall market share recovery and rerating. **We maintain our HOLD rating on the company.**

Target Price and Valuation: We, however raise our target multiple to 20x vs. 12x earlier, to account for this new development. We value Zee at ₹ 330/share.

Key triggers for future price performance:

- Outcome of shareholders' activism and deal completion
- Overall viewership share improvement, which has dipped in recent times. Turnaround in some of the regional markets like Tamil/Marathi as well as Hindi GEC, where they have lost viewership market share recently

Key Financial Summary

(Year-end March)	FY19	FY20	FY21	5 year CAGR FY16-21	FY22E	FY23E	2 year CAGR FY21-23E
Net Sales (₹ crore)	7,933.9	8,129.9	7,729.9	5.7	8,323.6	9,360.3	10.0
EBITDA (₹ crore)	2,567.6	1,634.6	1,790.1	3.5	1,955.3	2,340.1	14.3
Net Profit (₹ crore)	1,545.8	526.5	800.1		1,280.9	1,577.5	
Adjusted Nat Profit (₹ crore)	1,573.4	1,661.5	984.9	(1.2)	1,283.6	1,577.5	26.6
EPS (₹)	16.1	5.5	8.3		13.3	16.4	
P/E (x)	20.9	61.4	40.4		25.3	20.5	
Price / Book (x)	3.2	3.3	3.1		2.9	2.7	
EV/EBITDA (x)	11.8	19.2	17.0		15.6	12.9	
RoE (%)	15.7	16.7	9.4		11.7	13.0	
RoCE (%)	25.7	13.9	13.7		16.1	17.6	

Source: Company, ICICI Direct Research



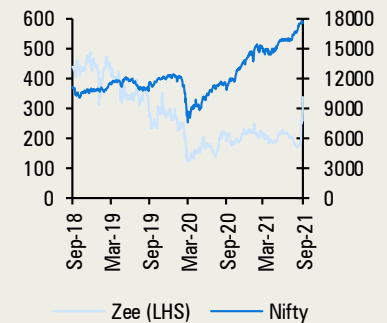
Particulars

Particulars	Amount
Market Cap (₹ crore)	32,349
Total Debt (FY21) (₹ crore)	20
Cash & Inv. (FY21) (₹ crore)	1,857
EV (₹ crore)	30,511
52 week H/L (₹)	355/ 167
Equity capital (₹ crore)	96.1
Face value (₹)	1.0

Shareholding pattern

	Sep-20	Dec-20	Mar-21	Jun-21
Promoters	4.0	4.0	4.0	4.0
DII	11.0	11.9	12.3	18.1
FII	66.2	65.8	64.2	57.5
Other	18.8	18.3	19.6	20.5

Price Chart



Key Risks

- (i) Any delay to deal fructification and shareholders' activism
- (ii) Faster recovery in advertisement

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Other highlights

- The company indicated that it has current cash of ~US\$175 million (mn) and along with SPNI cash infusion of ~US\$1.575 billion (bn), it is likely to enhance the overall growth ammunition. **We highlight that the company indicated that there is investment opportunity across digital, GEC and sports business, with cash deployment strategy to be decided by the merged entity board.** SPNI's press release mentions that cash will be used *"to enhance the combined company's digital platforms across technology and content, ability to bid for broadcasting rights in the fast-growing sports landscape and pursue other growth opportunities"*
- On the synergy front**, the company indicated that synergies typically have been to the extent of 6-10% of revenue, historically, driven by expanded reach. It also indicated that revenue based synergy will be key focus initially with digital and subscription to be major areas. The company indicated that both brands have distinct viewership and presence and expect them to coexist. It also indicated that while there is overlap in Hindi GEC and movies business, both companies have distinct content properties. Furthermore, board of the merged entity will evaluate rationalisation of any of the properties, if required. **Key benefit, in our view, will be complementary strength of Zee in the regional space and presence of comedy, kids and sports genre in SPNI portfolio. We also expect sports offering to enhance the OTT monetisation strength, albeit clear demarcation into two separate platform- one for sports led and other for movies/ originals later cannot be ruled out**
- The deal specifies that Zee's promoter group's stake can potentially increase to 20% subject to regulatory approvals. However, the route for the same has not been finalised. **We note that the conditions of price, mode etc. will be key. Moreover, given the stress at Zee at the promoter level, the increase in stake, at least, does not look likely in near term**
- The company indicated that given that it is a merger scheme, no open offer is required for this deal. **However, given that there is going to be change in control with SPNI controlling the majority on board, there could an event wherein open offer may be required, in our view**
- Why we do not turn buyers?**
 - The stock has doubled from lows and largely factors in the transition into a superior merged entity. Furthermore, **improvement in business metric – market share, margins, cash generation etc. will be key for overall multiple rerating**
 - Historical experience of group's M&A activities** – (read Dish TV Videocon merger) has not been on expected levels synergy creator
 - Due diligence process is due. Furthermore, **activity on Oppenheimer front - seeking to remove Punit Goenka as MD/CEO – could lead to volatility in the interim period**

Exhibit 1: Zee and SPNI broad financial

₹ Crore	SPNI		Zee	
	FY20	FY21	FY20	FY21
Ad Revenues	2,877	2,563	4,681	3,749
Subscription	2,435	2,329	2,887	3,243
Others	470	748	561	738
Total Operating revenues	5,781	5,640	8,130	7,730
EBITDA	1,311	NA	1,635	1,790
Margins (%)	22.7		20.1	23.2
PAT	976.0	563.6	526.5	800.1

Source: Capitaline, Exchange4Media.com ICICI Direct Research;

Financial Summary

Exhibit 2: Profit and loss statement				
	₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E
Total operating Income	8,129.9	7,729.9	8,323.6	9,360.3
Growth (%)	18.7	-4.9	7.7	12.5
Operational Cost	3,828.5	3,750.5	3,934.5	4,212.1
Employee Expenses	780.5	818.3	918.5	1,029.6
Admin & Other Expenses	1,190.7	754.4	780.6	936.0
Marketing Expenses	695.6	616.7	734.8	842.4
Total Operating Expenditure	6,495.3	5,939.8	6,368.3	7,020.2
EBITDA	1,634.6	1,790.1	1,955.3	2,340.1
Growth (%)	-36.3	9.5	9.2	19.7
Depreciation	270.6	264.9	283.0	318.2
Interest	144.9	57.1	37.9	30.0
Other Income	24.0	-85.8	98.8	110.0
Exceptional Items	284.3	126.6	3.7	0.0
PBT	958.7	1,255.7	1,729.5	2,101.8
Minority Interest	-1.9	-7.0	-5.0	-5.0
PAT from Associates	-2.4	-0.1	0.3	0.4
Total Tax	431.7	462.5	453.9	529.7
PAT	526.5	800.1	1,280.9	1,577.5
Growth (%)	-65.9	52.0	60.1	23.2
Adjusted PAT	1,661.5	984.9	1,283.6	1,577.5
Growth (%)	5.6	-40.7	30.3	22.9
Reported EPS (₹)	5.5	8.3	13.3	16.4

Source: Company, ICICI Direct Research

Exhibit 4: Balance Sheet				
	₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E
Liabilities				
Equity Capital	96.1	96.1	96.1	96.1
Preference Share Capital	595.0	383.2	0.0	0.0
Reserve and Surplus	9,247.9	9,998.5	10,895.1	11,992.4
Total Shareholders funds	9,938.9	10,477.7	10,991.2	12,088.5
Total Debt	52.6	19.5	19.5	19.5
Others	11.0	12.9	8.0	3.0
Total Liabilities	10,002.5	10,510.2	11,018.7	12,111.0
Assets				
Gross Block	2,136.7	2,317.5	2,541.3	2,703.9
Less: Acc Depreciation	1,179.2	1,444.1	1,727.1	2,045.4
Net Block	957.5	873.4	814.2	658.5
Capital WIP	33.4	12.9	12.9	12.9
Total Fixed Assets	990.9	886.3	827.1	671.4
Investments	731.7	1,178.7	1,178.7	1,578.7
Inventory	5,347.5	5,403.0	5,701.1	6,411.1
Debtors	2,128.6	1,945.2	2,094.6	2,355.4
Loans and Advances	1,323.4	1,138.2	1,348.1	1,516.0
Other Current Assets	373.2	341.8	368.0	413.9
Cash	734.5	1,090.7	1,046.2	925.4
Total Current Assets	9,907.2	9,918.8	10,558.0	11,621.9
Creditors	1,680.3	1,398.2	1,482.3	1,666.9
Provisions	152.6	170.9	181.2	203.7
Other current liabilities	582.2	739.5	716.7	725.3
Total Current Liabilities	2,415.2	2,308.6	2,380.1	2,595.9
Net Current Assets	7,492.0	7,610.2	8,177.9	9,025.9
Other non current assets	787.9	834.9	834.9	834.9
Total Assets	10,002.5	10,510.2	11,018.7	12,111.0

Source: Company, ICICI Direct Research

Exhibit 3: Cash flow statement				
	₹ crore			
(Year-end March)	FY20	FY21	FY22E	FY23E
Profit after Tax	526.5	800.1	1,280.9	1,577.5
Add: Depreciation	270.6	264.9	283.0	318.2
Add: Interest paid	144.9	57.1	37.9	30.0
(Inc)/dec in Current Assets	-865.9	344.5	-683.7	-1,184.6
Inc/(dec) in CL and Provisions	-340.1	-106.6	71.6	215.8
Others	0.0	0.0	0.0	0.0
CF from op. activities	-263.9	1,360.0	989.7	957.0
(Inc)/dec in Investments	651.8	-473.6	0.0	-400.0
(Inc)/dec in Fixed Assets	-216.2	-160.3	-223.8	-162.6
Others	58.1	-18.6	-5.0	-5.0
CF from inv. activities	493.8	-652.4	-228.8	-567.5
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Issue of Preference Shares	-516.3	-211.8	-383.2	0.0
Inc/(Dec) in loan funds	50.6	(33.1)	-	-
Interest paid	144.9	57.1	37.9	30.0
Others	-396.3	-163.6	-460.0	-540.2
CF from fin. activities	-717.1	-351.4	-805.3	-510.2
Net Cash flow	-487.4	356.1	-44.5	-120.8
Opening Cash	1,221.8	734.5	1,090.7	1,046.2
Closing Cash	734.5	1,090.7	1,046.2	925.4

Source: Company, ICICI Direct Research

Exhibit 5: Key ratios				
(Year-end March)	FY20	FY21	FY22E	FY23E
Per share data (₹)				
EPS	5.5	8.3	13.3	16.4
Adjusted EPS	17.3	10.3	13.4	16.4
BV	103.5	109.1	114.4	125.9
DPS	0.4	2.5	4.0	5.0
Cash Per Share	12.3	15.0	18.0	21.3
Operating Ratios (%)				
EBITDA Margin	20.1	23.2	23.5	25.0
EBIT Margin	16.8	19.7	20.1	21.6
PAT Margin	20.4	12.7	15.4	16.9
Inventory days	240.1	255.1	250.0	250.0
Debtor days	95.6	91.8	91.8	91.8
Creditor days	75.4	66.0	65.0	65.0
Return Ratios (%)				
RoE	16.7	9.4	11.7	13.0
RoCE	13.9	13.7	16.1	17.6
RoIC	16.3	18.7	19.2	21.2
Valuation Ratios (x)				
P/E	61.4	40.4	25.3	20.5
EV / EBITDA	19.2	17.0	15.6	12.9
EV / Net Sales	3.9	3.9	3.7	3.2
Market Cap / Sales	4.0	4.2	3.9	3.5
Price to Book Value	3.3	3.1	2.9	2.7
Solvency Ratios				
Debt/EBITDA	0.0	0.0	0.0	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	5.0	5.6	5.7	5.7
Quick Ratio	2.1	2.2	2.3	2.3

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: < -15%



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