Zee Entertainment Enterprises Ltd

Right fit for growth

Consumer Discretionary	Sharekhan code: ZEEL	Event Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)		✓	
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	+	↔	+
RQ	=	↔	=
RV	+	↔	+

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 337**	
Price Target: **Rs. 400**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

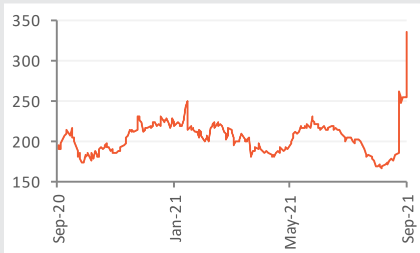
Company details

Market cap:	Rs. 32,379 cr
52-week high/low:	Rs. 355 / 166
NSE volume: (No of shares)	168.7 lakh
BSE code:	505537
NSE code:	ZEEL
Free float: (No of shares)	92.2 cr

Shareholding (%)

Promoters	4.0
FII	68.2
DII	20.4
Others	7.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	98	56	64	71
Relative to Sensex	92	43	44	15

Sharekhan Research, Bloomberg

Summary

- ZEEL & Sony Pictures Networks India (SPNI) have entered into a non-binding term sheet to merge themselves. This will create the largest media company with a market share of ~25% in India.
- Merged entity will be well-placed to maximize revenue given its strong potential to reach a larger number of advertisers. Synergies would have an impact of 6-10% on revenue.
- As Sony will be the promoter of the combined entity, we believe the corporate governance overhang on ZEEL would fade away and boost investors' confidence.
- We maintain a Buy on the stock with a revised PT of Rs. 400. Growth capital would be used to accelerate its digital platform growth and invest in premier content including sports.

ZEE Entertainment Limited (ZEEL) & Sony Pictures Networks India (SPNI) have entered into a non-binding term sheet to combine both companies' linear networks, digital assets, production operations and program libraries. The merger will create India's largest media & entertainment (M&E) company across languages and genres, with a ~25% market share in India. The combined entity will be in a superior position to maximize revenues given its reach potential and investments on digital and sports business.

- **Non-binding term sheet with Sony for a proposed merger:** ZEEL and SPNI announced a merger of both the companies in India. SPNI will infuse growth capital of $1.6 billion into the merger entity, which would increase its holding to 53% of the merged entity. As part of the deal, Sony will transfer stake of the merged entity to ZEEL's promoter to maintain 4% stake in the combined entity as part of non-compete arrangements, which would lead to increase the stake of the ZEEL's shareholders to 49%. Sony Group Corporation (Japan) will be the promoter of the combined entity and majority of the Board of Directors of the merged entity will be nominated by Sony.
- **A strategic fit:** The merger will create the largest M&E company in India across languages and genres, with a market share of ~25%. We note that Sony is strong in Hindi GEC segment, Kids, English movies and sports properties, where ZEEL is strong in regional GEC markets and Hindi movies space (even Sony has a strong movie catalogue). Though there would be an overlap in Hindi GEC and movies business, management cited that both the platforms have unique content in the respective business. Management believes the impact of synergies would be to the extent of 6-10% on revenue. Given strong franchises with high quality content of both the companies along with dominant market share, the combined entity will have a better reach potential in terms of larger number of advertisers.
- **Corporate governance concerns ease:** As Sony Group Corporation (Japan) will be the promoter of the combined company, we believe the corporate governance overhang on ZEEL would fade away and boost investors' confidence. Management stated that priority of focus of the combined entity would be 1) advertisement, 2) subscription, and 3) international business.

Our Call

Valuation: Likely to address multiple issues: We believe the proposed merger would be a strategic fit from a revenue perspective as it would strengthen ZEEL's portfolio with sport, kids and English movie properties. Further, with the infusion of growth capital of $1.6 billion by SPNI, the combined entity's cash balance would increase to ~$1.8 billion, which would be used to accelerate its digital platform growth and invest in premier content including sports. We believe that corporate governance concerns will get addressed with the controlling stake of SPNI and this will trigger multiple re-ratings for ZEEL. The stock is currently trading at a reasonable valuation at 20x/18x of FY2023E/FY2024E earnings estimates. Hence, we maintain a Buy rating on ZEEL with a revised PT of Rs. 400.

Key risk

(1) A slowdown in the economy leading to lower demand and subdued realisation for advertisement revenue stream, 2) delay in monetisation benefit from digitisation could affect earnings, and 3) potential ownership change at ZEEL as promoters own less than 4%.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenues	7,729.9	8,312.5	9,235.8	10,047.3
OPM (%)	23.2	23.5	25.5	26.1
Adjusted PAT	1,122.9	1,293.5	1,651.5	1,836.7
% YoY growth	*123.8*	*15.2*	*27.7*	*11.2*
Adjusted EPS (Rs.)	11.7	13.5	17.2	19.1
P/E (x)	28.8	25.0	19.6	17.6
P/B (x)	3.2	2.9	2.6	2.4
EV/EBITDA (x)	17.7	15.1	12.0	10.4
RoNW (%)	11.1	11.7	13.4	13.4
RoCE (%)	14.7	15.2	17.1	17.3

Source: Company; Sharekhan estimates

Event: Non-binding term sheet with Sony Pictures for a proposed merger

ZEEL's board provided an in-principle approval for the merger between Sony Pictures Networks India (SPNI) & ZEEL. ZEEL & SPNI have entered into a non-binding term sheet to combine both their linear networks, digital assets, production operations and program libraries. The term sheet provides an exclusive period of 90 days during which ZEEL and SPNI will conduct mutual diligence and finalize definitive agreement(s). Basis the existing estimated equity values of ZEEL and SPNI, the indicative merger ratio of ZEEL and SPNI would be at 61.25% and 38.75%. As a part of the proposed transaction, SPNI will infuse growth capital of $1.6 billion into the merged entity. Post the merger, SPIN would own about 52.93% of the merged entity while ZEEL will hold approximately 47.07% in the merged company. Post-merger, the combined entity will be a publicly listed entity and become the largest media and entertainment (M&E) company in India.

As part of the proposed deal, Mr. Punit Goenka will continue as MD & CEO of the merged entity for the five years. Further, certain non-compete arrangements will be signed between the promoters of ZEEL and those of SPNI. According to the term sheet, the promoter family of ZEEL can increase its shareholding from the current 4% stake in ZEEL to up to 20%. Further, Sony Group Corporation (Japan) will be the promoter of the combined company and majority of the Board of Directors of the merged entity will be nominated by Sony.

A strategic fit

ZEEL signed a non-binding term sheet with SPNI to combine both companies' linear networks, digital assets, production, music operations and programme libraries. The merger will create the largest M&E company in India across languages and genres. We note that Sony is strong in Hindi GEC segment and sports, where ZEEL is strong in regional GEC markets and Hindi movies space (even Sony has a strong movie catalogue). Though both ZEEL and Sony have presence in Hindi GEC and movies business, management cited that both the companies have distinct content which would help them to capture higher viewership share. Management cited that the combined entity would have around 25% market share with revenue of around $2 billion. Management indicated that Sony has strong understanding of the global media landscape with the overall group's revenue of over $85 billion. Sony is a formidable player in Indian M&E industry and this proposed investment confirms their focus and commitment to significantly grow this business in India. Further, SPNI has a strong global franchise with high quality content and innovative technology-led solutions. The proposed merger is expected to strengthen ZEEL's portfolio with Sony's sport, kids and English movies content, which would be complementary to ZEEL's bouquet. Management stated that sports is an important element property for strong growth of OTT.

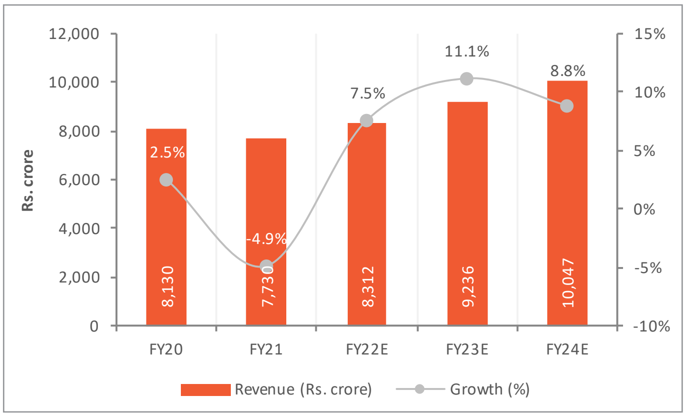
Key conference call highlights

- The proposed merged entity would become the largest M&E player in India and become the market leader across genres and languages. It would command a ~25% of total market share in the linear space and scale $2 billion to revenue.
- As part of the transaction, Sony will infuse $1.6 billion of cash as growth capital which will be used by the merged entity to accelerate its digital platform growth and significantly invest in premier content including sports.
- Based on the indicative initial merger ratio, post the infusion of cash by Sony the shareholder's ZEEL would have 47% stake in the combined entity.
- As part of deal, Sony will transfer the stake of the merged entity to Zee group to maintain the 4% stake of ZEEL's promoter group in the merged entity given non-compete arrangements. This would increase the stake of the ZEEL's shareholders to 49%.

- Management indicated that there would be no open offer for this merger.
- Sony will come on board as promoter of the merged entity and will have the right to appoint majority of directors in the board.
- Deal may take 6-8 months to close.
- Management cited that a three-fourths majority on shareholder vote will be required for the closure of the deal
- Management stated that ZEEL's promoter group holding can potentially increase to 20% subject to regulatory approvals. The route for the same has not be finalised yet.
- ZEEL has ~$170 million cash. Sony infuse capital of $1.6 billion to meet the shareholding ratio. This will take total cash balance of the combined entity to $1.8 billion.
- Management believes that synergies would be to the extent of 6%-10% on revenue side.
- Management stated that priority of focus would be 1) advertisement, 2) subscription, and 3) international business.
- Management will continue to focus on delivering strong return ratios for ZEEL.
- There would be no major overlaps of channels. However, ZEEL's management believes that each channels have distinct viewership and unique programing. Though there is an overlap in Hindi GEC and movies business, both the platforms have unique content in the respective business. Hence, both brands can coexist. Based on the requirements, management of the combined entity can evaluate for a third or combined brand to maximize the reach. The combined entity would focus on maximising revenue synergies.

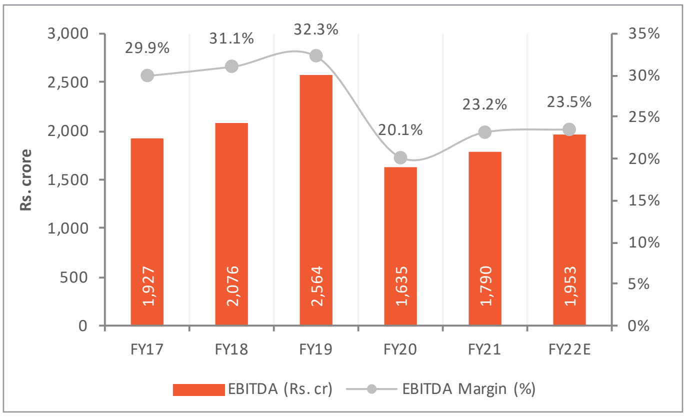
Financials in charts

Revenue (Rs. cr) and growth (%)



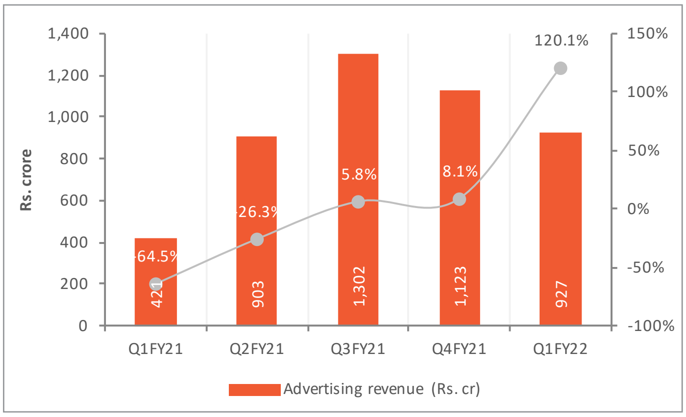
Source: Company, Sharekhan Research

EBITDA (Rs. cr) and EBITDA margin (%)



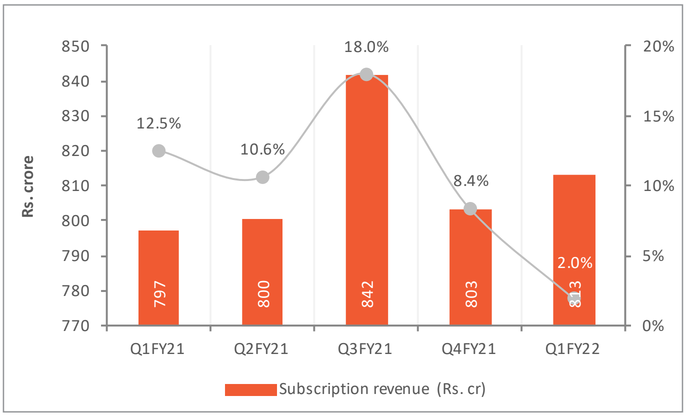
Source: Company, Sharekhan Research

Advertising revenue (Rs. cr) and growth (%)



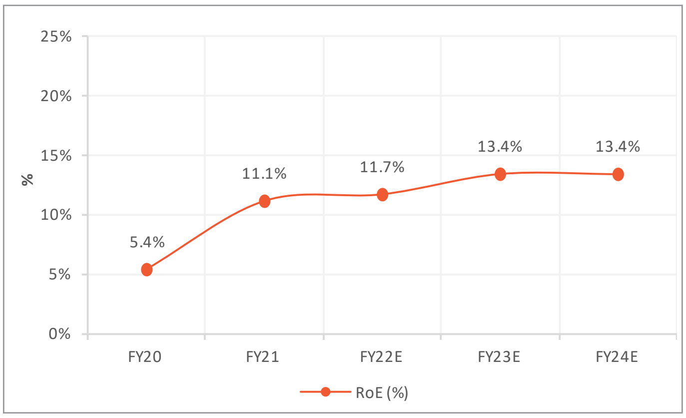
Source: Company, Sharekhan Research

Subscription revenue trend



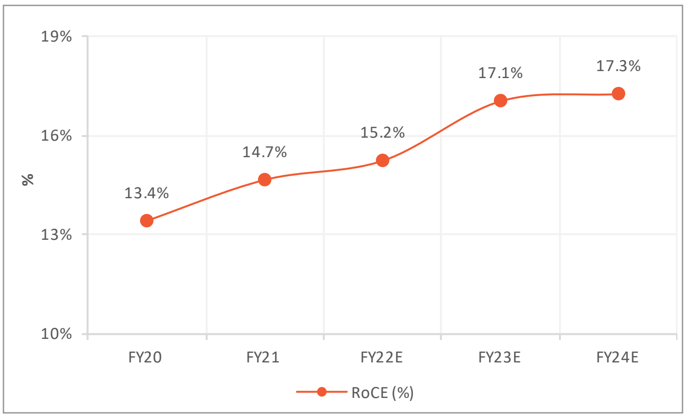
Source: Company, Sharekhan Research

RoE trend (%)



Source: Company, Sharekhan Research

RoCE trend (%)



Source: Company, Sharekhan Research

Outlook and Valuation

Sector View – Advertising growth recovery likely to remain strong

As per a KPMG report, the Indian media and entertainment (M&E) industry growth would be significantly impacted in FY2021 owing to nationwide lockdown restrictions owing to the pandemic, slowdown in advertising spends and breaking down of content supply chains. However, the M&E sector is expected to bounce back in FY2022 with a 33.1% y-o-y growth to reach a size of Rs. 1.86 trillion. The television segment is expected to revert to 8.6% y-o-y in FY2022 on account of a strong 19% growth in ad revenue and 4% growth in subscription revenue. We expect television as a medium to continue to stay relevant and the most preferred choice for advertisers, given its reach to the mass audience.

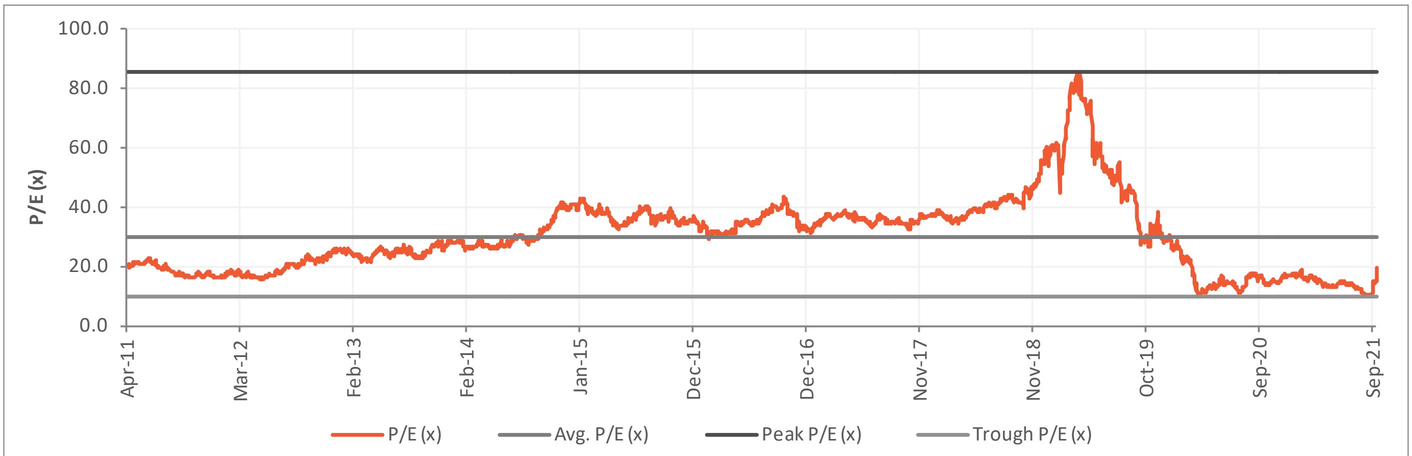
Company Outlook – Proposed merger would enhance its reach potential

ZEEL is one of India's leading media & entertainment companies, primarily engaged in broadcasting, movies and music production, and digital business. The company has a strong presence in the GEC segment, given deep regional penetration and has expanded its presence in movie genre with the launch of new channels. We believe ZEE5's focus on aggressively building a content catalogue is a step in the right direction given the hyper-competitive nature of the market. The proposed merger is expected to strengthen ZEEL's portfolio with Sony's sport, kids and English movie content. Management stated that priority of focus of the combined entity would be 1) advertisement, 2) subscription, and 3) international business. The combined entity will be in a superior position on maximizing its revenue given its reach potential and investments on digital and sports business.

Valuation – Proposed merger likely to address multiple issues

We believe the proposed merger would be a strategic fit from a revenue perspective as it would strengthen ZEEL's portfolio with sport, kids and English movie properties. Further, with the infusion of growth capital of $1.6 billion by SPNI, the combined entity's cash balance would increase to ~$1.8 billion, which would be used to accelerate its digital platform growth and invest in premier content including sports. We believe that corporate governance concerns will get addressed with the controlling stake of SPNI and this will trigger multiple re-ratings for ZEEL. The stock is currently trading at a reasonable valuation at 20x/18x of FY2023E/FY2024E earnings estimates. Hence, we maintain a Buy rating on ZEEL with a revised PT of Rs. 400.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

ZEEL is one of India's largest vertically-integrated media and entertainment companies, primarily engaged in broadcasting and content development with the widest language footprint, movies and music production, live events, and digital business. The company is amongst the largest producers and aggregators of entertainment content in the world, with an extensive library housing over 250,000 hours of television content. ZEEL houses the world's largest Hindi film library with rights to more than 4,200 movie titles from foremost studios and of iconic film stars. Through its strong presence worldwide, ZEEL is present across 170+ countries and has a reach to over 1.3 billion viewers.

Investment theme

The company has delivered a strong revenue CAGR of 8% over FY2015-FY2021 despite strict lockdown restrictions owing to outbreak of COVID-19 in FY2021.ZEEL's management remains confident of delivering advertising revenue growth, ahead of industry growth rate. Hence, the company is considered as one of the leading players under the structural India consumption theme. The proposed merger with SPNI will create the largest media company in India across languages and genres, with around 25% market share.

Key Risks

Unfavourable regulatory guidelines impacting subscription revenue, a slowdown in the economic environment leading to lower demand, and subdued realisation for advertisement revenue stream. Delay in monetisation benefit from digitisation and increased investments in ZEE5 could affect earnings.

Additional Data

Key management personnel

Punit Goenka	Managing Director and CEO
Amit Goenka	President - Digital Businesses & Platforms
Anurag Bedi	Chief Business Officer – Zee Music
Rohit Kumar Gupta	Chief Financial Officer
Ashish Agarwal	Chief Compliance Officer & Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Invesco Limited	17.88
2	OFI GBL China FD LLC	10.14
3	Invesco Oppenheimer	7.74
4	Vanguard Group Inc/The	5.94
5	Life Insurance Corp of India	4.89
6	HSBC Holding PLC	4.10
7	Vanguard International	3.48
8	Amansa Capital Private Limited	3.40
9	Vontobel Holding AG	3.01
10	Government pension fund global	2.47

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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