Zee Entertainment Enterprises (Z IN)

Rating: BUY | CMP: Rs318 | TP: Rs405

September 23, 2021

Event Update

■ Change in Estimates | ☑ Target | ■ Reco

Change in Estimates

	Current		Previous	
	FY23E	FY24E	FY23E	FY24E
Rating	**BUY**		**BUY**	
Target Price	**405**		**303**	
Sales (Rs. m)	90,365.1	98,805.6	90,365.1	98,805.6
% Chng.	-	-		
EBITDA (Rs. m)	23,404.6	27,468.0	23,404.6	27,468.0
% Chng.	-	-		
EPS (Rs.)	16.8	19.9	16.8	19.9
% Chng.	-	-		

Key Financials - Consolidated

Y/e Mar	FY21	FY22E	FY23E	FY24E
Sales (Rs. m)	77,299	81,908	90,365	98,806
EBITDA (Rs. m)	17,901	18,511	23,405	27,468
Margin (%)	*23.2*	*22.6*	*25.9*	*27.8*
PAT (Rs. m)	11,971	12,635	16,177	19,102
EPS (Rs.)	12.5	13.2	16.8	19.9
Gr. (%)	*(30.0)*	*5.5*	*28.0*	*18.1*
DPS (Rs.)	2.5	3.3	4.2	5.0
Yield (%)	*0.8*	*1.0*	*1.3*	*1.6*
RoE (%)	*12.3*	*12.0*	*13.9*	*14.7*
RoCE (%)	*14.9*	*14.6*	*17.3*	*18.4*
EV/Sales (x)	3.8	3.5	3.1	2.7
EV/EBITDA (x)	16.3	15.4	11.9	9.8
PE (x)	25.5	24.2	18.9	16.0
P/BV (x)	3.0	2.8	2.5	2.2

Key Data	ZEE.BO | Z IN
52-W High / Low	Rs.363 / Rs.167
Sensex / Nifty	59,885 / 17,823
Market Cap	Rs.306bn/ $ 4,150m
Shares Outstanding	961m
3M Avg. Daily Value	Rs.9725.12m

Shareholding Pattern (%)

Promoter's	3.99
Foreign	57.46
Domestic Institution	18.47
Public & Others	20.08
Promoter Pledge (Rs bn)	0.41

Stock Performance (%)

	1M	6M	12M
Absolute	87.2	49.6	65.9
Relative	73.7	25.1	4.4

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Synergy from SPNI merger to drive re-rating

Quick Pointers:

- ZEEL signed a non-binding term sheet with Sony Pictures Network India (SPNI) for a merger with an indicative merger ratio of 53%/47% (SPNI: ZEEL), post capital infusion of US$1.575bn by SPNI.
- Puneet Goenka to continue as MD&CEO for 5 years with promoter family having an option to increase stake from 4% to 20%.

ZEEL's proposed merger with SPNI is a win-win situation, as it will likely 1) result in material revenue synergies (~6-10% due to better scale & reach) 2) drive growth, as merged entity will have cash ammunition of US$1.7bn to fund digital ambitions and 3) absolve uncertainty surrounding board room decision risks. Post-merger, network will have a market share of ~28%, thereby creating an all-encompassing portfolio present across genres. While Mr Punit Goenka is expected to continue as MD&CEO for a period of 5 years, newly constituted board will have SPNI's dominance with ZEEL's promoter family getting only one board seat. The deal will require approval of CCI, SEBI and existing shareholders (75% votes have to be in favor). We believe this development is positive and warrants a re-rating, as it not only results in material synergies but also brings an end to governance concerns. Consequently, we increase our target P/E multiple to 23x (earlier 18x) and arrive at a TP to Rs405, after incorporating merger synergies.

Deal contours: ZEEL's board has approved merger with SPNI with an indicative merger ratio of 53%:47% (SPNI: ZEEL), post capital infusion of US$1.575bn by SPNI. Post-merger, SPNI will be largest shareholder in the merged entity with promoter family of ZEEL having an option to increase their stake from 4% to 20%. The non-binding term sheet has an exclusivity period of 90 days and is subject to approval of shareholders (~75% majority required), CCI, NCLT and SEBI. The merger may take 6-8months to consummate and may not require an open offer.

Merger to result in synergy benefits: Post-merger the network will have market share of ~28%, surpassing Star-Disney which has viewership share of 25%. Increased reach/scale will benefit the merged entity and management expects revenue synergies of ~6-10% from this proposed merger.

Bouquet portfolio to widen post-merger: Post-merger, sports and kids segment, where ZEEL lacked presence, will form part of bouquet widening the genre presence of merged entity. SPNI has strong presence in Hindi-GEC (non-fiction category) while ZEEL has strong presence in RGEC. Overall, we believe the merger will fill in genre gaps of both entities but some channel rationalization cannot be ruled out in overlapping categories.

Cash ammunition of US$1.7bn to fuel growth: The merged entity will have a cash balance of US$1.7bn. Utilization of cash balance to grow the digital properties (makes the business future-proof) can turn out to be a key re-rating lever, in our view.

Key highlights from the call & way forward

Deal contours: ZEEL's board has approved merger with SPNI with an indicative merger ratio of 53%:47% (SPNI: ZEEL), post capital infusion of US$1.575bn by SPNI. Post-merger, SPNI will be the largest shareholder in merged entity with the promoter family of ZEEL having an option to increase the stake from 4% to 20%. Further, SPNI will transfer 2% stake to ZEEL's promoters towards a non-compete fee.

While Mr Punit Goenka is expected to continue as MD&CEO of merged entity for a period of 5 years, SPNI will have right to nominate majority of the Board of Directors. Apparently, from ZEEL's side only Mr Punit Goenka is likely to have a board seat.

The non-binding term sheet has an exclusivity period of 90 days and is subject to approval of shareholders (~75% majority required), CCI, NCLT and SEBI. The merger may take 6-8months to consummate and may not require an open offer.

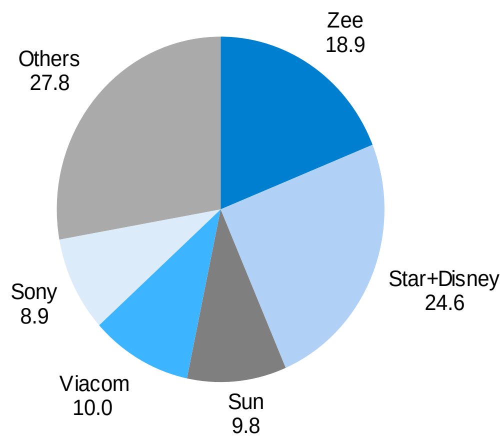
Exhibit 1: Indicative merger ratio pre & post capital infusion of US$1.575bn

Particulars	Pre-capital Infusion	Post-capital Infusion
ZEEL	61.25%	47.07%
SPNI	38.75%	52.93%

Source: Company, PL

Merger to result in synergy benefits: As of 4QFY21, ZEEL/SPNI had a network viewership share of 19%/9% respectively. Post-merger, the network will have a market share of ~28%, surpassing Star-Disney which has a viewership share of 25%. Increased reach/scale will benefit merged entity and management expects revenue synergies of ~6-10% from the proposed merger. Synergy from ad-revenue will be highest followed by subscription and international.

Exhibit 2: ZEEL-SPNI merger to result in combined network share of 28%



Source: Company, PL ** Figures as of 4QFY21*

Bouquet portfolio to widen post-merger: Post-merger, sports and kids segment, where ZEEL lacked presence, will form part of bouquet widening the genre presence of merged entity. While ZEEL exited sports business by selling Ten Sports to SPNI in 2017, evolution of digital landscape has made sports properties attractive as per management. Further, SPNI has strong presence in Hindi-GEC non-fiction segment with marquee shows like KBC, Indian Idol etc where-as ZEEL does not have high impact properties in this sub-segment except for SaReGaMa.

Nonetheless, ZEEL has strong presence in RGEC where SPNI does not have the right depth in terms of channel presence. Overall, we believe this merger will fill genre gap of each entity, but some channel rationalization cannot be ruled out in overlapping categories.

Exhibit 3: Merged entity to have presence across all genres

Genre	ZEEL	Sony	TV18	Star India	ZEEL+ Sony
Hindi GEC	Yes	Yes	Yes	Yes	Yes
Hindi movies	Yes	Yes	Yes	Yes	Yes
RGEC	Yes	Yes	Yes	Yes	Yes
Music (Eng/Hindi)	Yes	Yes	Yes	No	Yes
Kids (Eng/Hindi)	No	Yes	Yes	Yes	Yes
Sports (Eng/Hindi)	No	Yes	Yes**	Yes	Yes
News (Hindi/Eng/Regional)	Yes*	No	Yes	No	Yes*
Infotainment/Niche/English	Yes	Yes	Yes	Yes	Yes

Source: Company, PL

** Presence is via group company Zee Media Corporation Ltd*

***Expected to launch a sports channel soon*

Exhibit 4: SPNI has high impact properties in non-fiction genre

Sony	Star Plus	Colors	ZEEL
KBC	Nach Baliye	Big Boss	Sa Re Ga Ma Pa
Indian Idol	MasterChef India	Fear Factor: Khatron Ke Khiladi	Dance India Dance
India's Best Dancer	Dance Plus		
The Kapil Sharma Show			

Source: Company, PL

Cash ammunition of US$1.7bn to fuel growth: SPNI is infusing US$1.575bn as growth capital while ZEEL has cash balance of US$170mn as of June taking the merged entity cash balance to US$1.745bn (~Rs131bn), which can be utilized to evaluate opportunities in digital as well as linear TV.

Amid proliferation of OTTs and shift in viewing habits (from linear TV to digital), the viewership landscape is likely to evolve in coming years and we expect higher spends on digital side. Utilization of cash balance to grow digital properties (makes the business future-proof) can turn out to be a key re-rating lever, in our view.

Exhibit 5: Netflix & Amazon Prime lead the video OTT market

OTT platform	Market share
Netflix	20%
Amazon Prime Video	20%
Disney + Hotstar	17%
ZEE5	9%
SonyLIV	4%
ALTBalaji	4%

Source: Livemint, PL

Financial implications of the merger: SPNI had a topline of Rs55.9bn with PAT of Rs5.8bn in FY21. Brief summary of financials including revenue breakdown is given in the tables below: -

Exhibit 6: Income Statement of SPIN

Particulars (Rs mn)	FY19	FY20	FY21
Revenue from Operations	**63,364**	**59,076**	**55,977**
YoY Growth		*-6.8%*	*-5.2%*
Expenditure on production	45,270	33,193	31,900
YoY Growth		*-26.7%*	*-3.9%*
As a % of sales	*71.4%*	*56.2%*	*57.0%*
Employee benefit expenses	4,125	4,644	4,264
YoY Growth		*12.6%*	*-8.2%*
As a % of sales	*6.5%*	*7.9%*	*7.6%*
A&P spends	3,096	5,305	6,163
YoY Growth		*71.4%*	*16.2%*
As a % of sales	*4.9%*	*9.0%*	*11.0%*
Other expenses	3,069	2,220	2,614
YoY Growth		*-27.7%*	*17.8%*
As a % of sales	*4.8%*	*3.8%*	*4.7%*
Operating expenses	55,560	45,362	44,942
YoY Growth		*-18.4%*	*-0.9%*
As a % of sales	*87.7%*	*76.8%*	*80.3%*
EBITDA	**7,804**	**13,714**	**11,036**
YoY Growth		*75.7%*	*-19.5%*
EBITDA margin	*12.3%*	*23.2%*	*19.7%*
Depreciation & Amortization	1,808	2,459	2,504
YoY Growth		*36.0%*	*1.8%*
As a % of sales	*2.9%*	*4.2%*	*4.5%*
EBIT	**5,996**	**11,255**	**8,532**
YoY Growth		*87.7%*	*-24.2%*
EBIT margin	*9.5%*	*19.1%*	*15.2%*
Finance cost	591	311	92
YoY Growth		*-47.4%*	*-70.4%*
As a % of sales	*0.9%*	*0.5%*	*0.2%*
Other income	890	535	1,239
YoY Growth		*-39.8%*	*131.6%*
As a % of sales	*1.4%*	*0.9%*	*2.2%*
PBT before exceptional items	6,295	11,479	9,679
Exceptional items	-	-	-
PBT	**6,295**	**11,479**	**9,679**
YoY Growth		*82.4%*	*-15.7%*
PBT margin	*9.9%*	*19.4%*	*17.3%*
Current Tax	644	2,213	2,994
Deferred tax	1,508	311	862
Total tax expense	2,151	2,524	3,856
Tax rate	*34.2%*	*22.0%*	*39.8%*
PAT	**4,143**	**8,955**	**5,823**
YoY Growth		*116.1%*	*-35.0%*
PAT margin	*6.5%*	*15.2%*	*10.4%*

Source: Company, PL

Exhibit 7: Revenue breakdown of SPNI

Particulars (Rs mn)	FY19	FY20	FY21
Revenue			
Advertisements Income	33,372	30,165	26,324
Subscription Income	21,868	26,262	24,847
Licensing Income	7,967	2,321	4,234
Distribution and Licensing of Movies	157	-	382
Sale of Programs	-	328	190
Total revenue	**63,364**	**59,076**	**55,977**
% of sales			
Advertisements Income	52.7%	51.1%	47.0%
Subscription Income	34.5%	44.5%	44.4%
Licensing Income	12.6%	3.9%	7.6%
Distribution and Licensing of Movies	0.2%	0.0%	0.7%
Sale of Programs	0.0%	0.6%	0.3%

Source: Company, PL

We have forecasted pro-forma P&L of merged entity based on the following assumptions: -

- We use our existing estimates of ZEEL.
- We assume 5% revenue synergy and no cost synergy from FY23 onwards. FY22 does not account for any benefits.
- We factor in cash cushion of US$1.7bn (other income increased accordingly) into our assumptions.
- Outstanding shares of the merged entity are calculated based on merger ratio given.

Exhibit 8: Merged entity pro-forma financials

Particulars (Rs mn)	FY22E*	FY23E	FY24E
Revenue from Operations	1,36,206	1,54,177	1,66,004
YoY Growth		*13.2%*	*7.7%*
EBITDA	29,371	35,263	41,105
EBITDA margin	*21.6%*	*22.9%*	*24.8%*
PAT	17,931	31,461	35,910
PAT margin	*13.2%*	*20.4%*	*21.6%*
Outstanding shares(In mn)	2,040.8	2,040.8	2,040.8
EPS (Rs)	8.8	15.4	17.6
Target P/E			23
TP (Rs)			**405**

Source: Company, PL

** Does not take into account merger timeline into consideration*

Assuming a target P/E of 23x given receding governance risks, scale/size advantage and expected revenue synergies, we arrive at a TP of Rs405 based on FY24 EPS of Rs17.6, if the merger goes through.

Financials

Income Statement (Rs m)

Y/e Mar	FY21	FY22E	FY23E	FY24E
Net Revenues	**77,299**	**81,908**	**90,365**	**98,806**
YoY gr. (%)	*(4.9)*	*6.0*	*10.3*	*9.3*
Cost of Goods Sold	37,505	39,725	42,020	44,957
Gross Profit	39,795	42,182	48,345	53,849
Margin (%)	*51.5*	*51.5*	*53.5*	*54.5*
Employee Cost	8,183	8,764	9,217	9,584
Other Expenses	7,544	8,191	8,585	9,090
EBITDA	**17,901**	**18,511**	**23,405**	**27,468**
YoY gr. (%)	*9.5*	*3.4*	*26.4*	*17.4*
Margin (%)	*23.2*	*22.6*	*25.9*	*27.8*
Depreciation and Amortization	2,649	2,785	3,163	3,557
EBIT	**15,252**	**15,726**	**20,242**	**23,911**
Margin (%)	*19.7*	*19.2*	*22.4*	*24.2*
Net Interest	571	287	154	148
Other Income	(858)	1,377	1,627	1,877
Profit Before Tax	**12,557**	**16,780**	**21,715**	**25,640**
Margin (%)	*16.2*	*20.5*	*24.0*	*26.0*
Total Tax	4,625	4,279	5,537	6,538
Effective tax rate (%)	*36.8*	*25.5*	*25.5*	*25.5*
Profit after tax	**7,931**	**12,501**	**16,177**	**19,102**
Minority interest	(70)	-	-	-
Share Profit from Associate	(1)	0	-	-
Adjusted PAT	**11,971**	**12,635**	**16,177**	**19,102**
YoY gr. (%)	*(30.0)*	*5.5*	*28.0*	*18.1*
Margin (%)	*15.5*	*15.4*	*17.9*	*19.3*
Extra Ord. Income / (Exp)	-	-	-	-
Reported PAT	**8,001**	**12,501**	**16,177**	**19,102**
YoY gr. (%)	*52.0*	*56.3*	*29.4*	*18.1*
Margin (%)	*10.4*	*15.3*	*17.9*	*19.3*
Other Comprehensive Income	(210)	156	-	-
Total Comprehensive Income	7,791	12,657	16,177	19,102
Equity Shares O/s (m)	**961**	**961**	**961**	**961**
EPS (Rs)	**12.5**	**13.2**	**16.8**	**19.9**

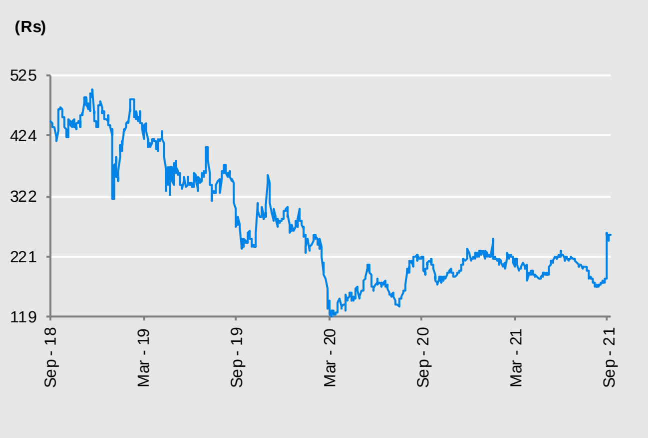
Source: Company Data, PL Research

Balance Sheet Abstract (Rs m)

Y/e Mar	FY21	FY22E	FY23E	FY24E
Non-Current Assets				
Gross Block	**19,969**	**22,721**	**25,759**	**29,379**
Tangibles	14,157	15,959	17,947	20,417
Intangibles	5,812	6,762	7,812	8,962
Acc: Dep / Amortization	**12,381**	**15,166**	**18,329**	**21,886**
Tangibles	8,348	10,158	12,214	14,526
Intangibles	4,033	5,008	6,115	7,360
Net fixed assets	**8,108**	**8,075**	**7,950**	**8,013**
Tangibles	6,329	6,321	6,253	6,411
Intangibles	1,779	1,754	1,697	1,602
Capital Work In Progress	755	755	755	755
Goodwill	3,804	3,804	3,804	3,804
Non-Current Investments	663	807	858	909
Net Deferred tax assets	3,151	3,859	5,212	6,154
Other Non-Current Assets	4,457	5,194	6,315	6,904
Current Assets				
Investments	7,667	7,667	7,667	7,667
Inventories	54,030	53,857	53,229	54,140
Trade receivables	19,452	19,074	21,044	23,010
Cash & Bank Balance	10,907	12,282	19,147	29,203
Other Current Assets	11,035	12,696	14,458	15,809
Total Assets	**128,187**	**132,498**	**145,247**	**161,555**
Equity				
Equity Share Capital	961	961	961	961
Other Equity	99,985	109,516	121,649	135,976
Total Networth	**100,945**	**110,477**	**122,610**	**136,936**
Non-Current Liabilities				
Long Term borrowings	195	195	195	195
Provisions	1,546	1,638	1,717	1,680
Other non current liabilities	-	-	-	-
Current Liabilities				
ST Debt / Current of LT Debt	3,832	-	-	-
Trade payables	13,982	14,138	14,359	15,701
Other current liabilities	7,558	5,921	6,237	6,914
Total Equity & Liabilities	**128,187**	**132,498**	**145,247**	**161,555**

Source: Company Data, PL Research

Price Chart



Recommendation History

No.	Date	Rating	TP (Rs.)	Share Price (Rs.)
1	15-Sep-21	BUY	303	256
2	7-Aug-21	BUY	253	197
3	7-Jul-21	BUY	278	219
4	21-May-21	BUY	278	192
5	7-Apr-21	BUY	296	201
6	5-Feb-21	BUY	296	249
7	11-Jan-21	BUY	290	231
8	5-Jan-21	BUY	290	219

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Dish TV India	NR	-	74
2	Entertainment Network (India)	Hold	214	199
3	Indian Railway Catering and Tourism Corporation	Hold	2,654	2,661
4	Inox Leisure	BUY	380	316
5	Music Broadcast	Hold	24	25
6	Navneet Education	Accumulate	111	102
7	Nazara Technologies	BUY	2,342	1,794
8	PVR	BUY	1,625	1,400
9	S Chand and Company	BUY	147	121
10	V.I.P. Industries	BUY	457	386
11	Zee Entertainment Enterprises	BUY	303	256

PL's Recommendation Nomenclature (Absolute Performance)

Buy : > 15%
Accumulate : 5% to 15%
Hold : +5% to -5%
Reduce : -5% to -15%
Sell : < -15%
Not Rated (NR) : No specific call on the stock
Under Review (UR) : Rating likely to change shortly

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