

## Zee Telefilms

STOCK INFO.	BLOOMBERG
BSE Sensex: 4,887	Z IN
S&P CNX: 1,556	REUTERS CODE
	ZEE.BO

16 October 2003

Buy

Previous Recommendation: Buy

Rs137

		YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
		END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
Equity Shares (m)	412.4	3/02A	10,762	1,946	4.7	11.6	29.1	7.0	24.0	24.0	5.9	20.8
52-Week Range	139/60	3/03A	12,079	2,491	6.0	28.0	22.8	6.8	29.7	27.3	5.2	16.6
1,6,12 Rel. Perf. (%)	21/34/-2	3/04E	13,873	3,008	7.3	20.8	18.8	5.0	30.6	32.6	4.2	12.8
M.Cap. (Rs b)	56.7											
M.Cap. (US\$ b)	1.3											

Zee Telefilms' 2QFY04 results are in line with our expectations, save for the lone positive surprise in advertising revenues. Revenues have grown 17.7% while PAT has grown by 22.8%. EBITDA margin has expanded by 210bp to 31.4% (we had expected 31.3%) while net margin has expanded by 80bp to 20.3%. While debtor days have fallen marginally to 150 in September 2003 compared to 152 in June 2003, the absolute level of debtors outstanding has gone up by Rs220m. The management claimed that it has generated cash of Rs3b during the quarter, which was used for debt repayment of Rs1.6b and led to an increase in cash & bank balances by Rs1.4b.

- Ad revenues better than expected with a 2.4% growth
- Subscription revenue momentum remains strong with a 23% growth
- Outlook bright: ad revenue bounce-back; robust subscription revenue growth

We expect Zee to post an EPS of Rs7.3 in FY04 (a growth of 20.8%) and Rs8.6 in FY05 (a growth of 17.5%). The stock quotes at 16x FY05E earnings and an EV of 10.3x FY05E EBITDA. We recommend **Buy**.

Y/E MARCH	(RS MILLION)							
	FY03				FY04		FY03	FY04E
	1Q	2Q	3Q	4Q	1Q	2Q		
Advertising Revenue	1,400	1,424	1,710	1,695	1,212	1,458	6,265	6,395
Subscription Revenue	1,016	1,211	1,242	1,318	1,428	1,489	4,849	5,900
Other Sales and Services	72	111	123	672	253	284	965	1,578
<b>Net Sales</b>	<b>2,488</b>	<b>2,746</b>	<b>3,075</b>	<b>3,685</b>	<b>2,893</b>	<b>3,231</b>	<b>12,079</b>	<b>13,873</b>
YoY Change (%)	6.5	10.8	10.2	16.7	16.3	17.7	12.2	14.8
Total Expenses	1,730	1,942	1,998	2,488	1,992	2,217	8,323	9,287
<b>EBITDA</b>	<b>758</b>	<b>804</b>	<b>1,077</b>	<b>1,197</b>	<b>901</b>	<b>1,014</b>	<b>3,757</b>	<b>4,586</b>
Margin (%)	30.5	29.3	35.0	32.5	31.1	31.4	31.1	33.1
YoY Change (%)	27.3	4.7	13.7	63.5	18.8	26.2	23.5	22.1
Other Income	162	197	175	238	191	164	785	795
Net Interest	182	200	227	155	170	192	767	495
Depreciation	57	81	71	95	82	70	297	360
Non-rec. Expenses							354	0
<b>PBT</b>	<b>682</b>	<b>721</b>	<b>955</b>	<b>1,185</b>	<b>841</b>	<b>916</b>	<b>3,124</b>	<b>4,526</b>
Tax	205	175	246	259	218	215	879	1,272
Tax Rate (%)	30.1	24.3	25.7	21.9	25.9	23.5	28.1	28.1
PAT	477	546	709	925	623	701	2,244	3,253
Minority Interest	1	11	21	105	48	45	108	73
<b>Adjusted PAT</b>	<b>476</b>	<b>535</b>	<b>688</b>	<b>820</b>	<b>575</b>	<b>656</b>	<b>2,491</b>	<b>3,181</b>
Margin (%)	19.1	19.5	22.4	22.3	19.9	20.3	20.6	22.9
YoY Change (%)	30.7	0.3	32.1	55.4	21.0	22.8	28.0	27.7

E: Inquire Estimates

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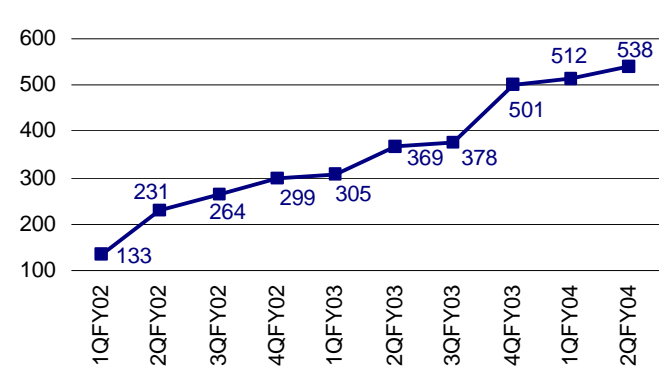
**Ad revenues better than expected with a 2.4% growth**

Advertising revenues for the quarter were Rs1.5b, a growth of 2.4% YoY and 20.3% QoQ. Stripping revenues of ETC Networks (which was consolidated with Zee 2QFY03 onwards), the ad revenue growth works out to 1% YoY. 2QFY04 saw the return of HLL on to the Zee network after being absent on Zee for multiple quarters. HLL ads were completely absent on Star Plus for two months (August-September 2003). Zee has obviously gained out of this to a certain extent, along with Sony TV and free to air channels, in terms of higher ad revenue flows. HLL has signed a new annual deal with Zee during the quarter.

**Subscription revenue momentum remains strong with a 23% growth**

Overall subscription revenues maintained their strong momentum with a growth of 22.9% YoY and 4.3% QoQ. All the segments – domestic pay, international pay and Siticable MSO – turned in strong performance. Domestic pay revenues for the quarter were Rs538m, a growth of 45.8% YoY and 5.1% QoQ. The paid domestic subscriber base at the end of the quarter remained flat sequentially at 4.6m.

QUARTERLY DOMESTIC PAY REVENUES (RS M)



Source: Company/Inquire

International pay revenues at Rs643m posted a growth of 13% YoY and 4% QoQ. The total subscriber base in international markets went up to 813,000 in September 2003 from about 600,000 in June 2003. Siticable MSO

operations posted revenues of Rs307m, a growth of 12.5% YoY and 2.8% QoQ (YoY comparison not really correct due to change in method of revenue recognition since 1QFY04).

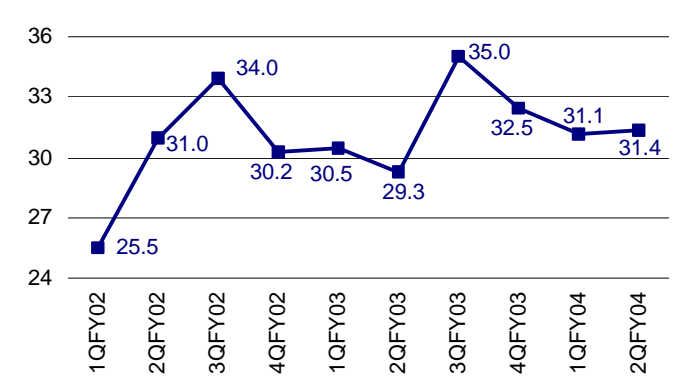
**Other sales & services below expectation at Rs284m**

Other sales & services for the quarter were below our expectation at Rs284m, a growth of 156% YoY and 12.1% QoQ. Education revenues stood at Rs35m, a YoY growth of 5.7%. Zee is all set to sell off the education and portal businesses but does not hope to get a large amount out of the sale of these businesses. Zee has already taken a write-off on account of the accumulated losses in these businesses in FY03.

**EBITDA margin expands 210bp, leading to 26% EBITDA growth**

EBITDA margin expanded to 31.4% leading to EBITDA growth of 26.2% YoY. However, this expansion comes on a low base recorded in 2QFY03. On a sequential basis, EBITDA margin expanded 30bp, leading sequential EBITDA growth of 12.5%. We expect FY04 EBITDA margins to be 33.1%.

QUARTERLY EBITDA MARGIN (%)



Source: Company/Inquire

Other income has been weak in 2QFY04, posting a decline of 14% QoQ and was at the lowest level in the last five quarters. Net interest for the quarter was Rs192m, a sequential growth of 13.2%.

The tax rate for the quarter was lower at 23.5% (effective tax rate on PBT) compared to 24.3% in 2QFY03 and 25.9% in 1QFY04.

PAT after minority interest was Rs656m, a growth of 22.8% YoY and 14.1% QoQ.

### No improvement in debtors position

While debtor days have fallen marginally to 150 in September 2003 from 152 in June 2003, absolute debtors outstanding (net after provisions) have actually risen by Rs220m sequentially to Rs5.1b from Rs4.9b in June 2003.

### Strong cash generation in the quarter - rise in cash balances & debt repayment

The company generated cash of Rs3b during the quarter. We are, however, not very clear about the reasons for such strong cash generation.

Cash & bank balances improved by Rs1.4b sequentially to Rs2.7b. Zee also retired debt to the extent of Rs1.6b during the quarter. With this round of debt repayment, Zee's outstanding debt must have fallen to Rs4.2b. In 2QFY04, the promoters repaid outstanding liabilities of Rs1.1b (the principal portion of the liability on account of Buddha Films). The interest outstanding on the Buddha Films liability is Rs690m as of September 2003.

### Outlook bright: ad revenue bounce-back; robust subscription revenue growth

We expect ad revenues to post a growth of 2.1% in FY04 and 4.6% in FY05. The ad revenue bounce-back witnessed in 2QFY04 will only accelerate in the coming quarters. The overall ad revenue growth is expected to bounce back to 12% after growing at 3-4% levels in the last two years. We expect the ad revenue growth on television to be at least 15% in CY03, which would be only better in CY04. New categories of advertisers, good monsoons leading to a rebound in FMCG sales and improving ad intensity of the economy (ad revenue/GDP) are the key drivers of this ad revenue buoyancy.

We estimate domestic subscription revenue growth of 28% in FY04 (Rs2b), followed by 42% growth in FY05 (Rs2.9b) on the back of CAS implementation (expected by 3QFY05). We expect international pay revenues to grow 15% in FY04 followed by a 7% growth in FY05. We expect Siticable MSO revenues to post 40% growth in FY04 and 30% in FY05.

We expect EBITDA margin to expand to 33.8% in FY05 from 31.1% in FY03.

### Valuation and view

We expect Zee to post an EPS of Rs7.3 in FY04 (a growth of 20.8%) and Rs8.6 in FY05 (a growth of 17.5%). The stock quotes at 16x FY05E earnings and an EV of 10.3x FY05E EBITDA. We recommend **Buy**.

#### EXPENSE MODEL

(RS MILLION)

	FY03				FY04		FY03	FY04E
	1Q	2Q	3Q	4Q	1Q	2Q		
Prog, Transmission, Education, Direct Exp.	1,041	1,129	1,117	1,339	1,287	1,390	4,867	5,620
Staff Cost	184	159	172	208	185	165	721	736
Administrative & Other Cost	505	654	709	941	520	662	2,734	2,931
<b>Total Expenses</b>	<b>1,730</b>	<b>1,942</b>	<b>1,998</b>	<b>2,488</b>	<b>1,992</b>	<b>2,217</b>	<b>8,323</b>	<b>9,287</b>

INCOME STATEMENT		(Rs Million)			
Y/E MARCH	2,002	2003	2004E	2005E	
Advertisement Revenues	6,605	6,265	6,395	6,686	
Subscription Revenues	3,169	4,849	5,900	7,311	
Other Sales & Services	989	965	1,578	1,950	
<b>Net Sales</b>	<b>10,762</b>	<b>12,079</b>	<b>13,873</b>	<b>15,947</b>	
Change (%)	10.2	12.2	14.8	15.0	
<b>Total Expenses</b>	<b>7,510</b>	<b>8,323</b>	<b>9,287</b>	<b>10,555</b>	
<b>EBITDA</b>	<b>3,252</b>	<b>3,757</b>	<b>4,586</b>	<b>5,392</b>	
Change (%)	30.2	15.5	22.1	17.6	
% of Net Sales	30.2	31.1	33.1	33.8	
Depreciation	215	297	360	388	
EBIT	3,037	3,460	4,226	5,004	
Other Income	792	785	795	537	
Interest & Finance Charges	808	767	495	163	
Non-recurring Expenses	0	354	0	0	
<b>PBT</b>	<b>3,022</b>	<b>3,124</b>	<b>4,526</b>	<b>5,377</b>	
Tax	888	973	1,312	1,613	
Deferred Tax	-23	-94	-40	-40	
Effective Rate (%)	29.4	31.1	29.0	30.0	
PAT	2,166	2,244	3,253	3,804	
Minority Interest	0	110	247		
<b>Adj. PAT</b>	<b>1,946</b>	<b>2,491</b>	<b>3,008</b>	<b>3,534</b>	
Change (%)	116	28.0	20.8	17.5	

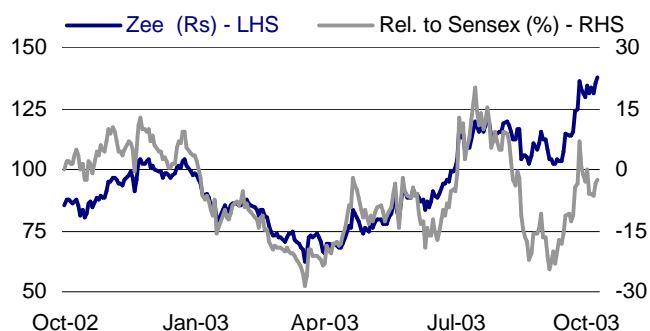
E: Inquire Estimates

BALANCE SHEET		(Rs Million)			
Y/E MARCH	2002	2003	2004E	2005E	
Share Capital	412	412	412	412	
Reserves	7,688	7,979	10,827	14,083	
<b>Net Worth</b>	<b>8,100</b>	<b>8,392</b>	<b>11,240</b>	<b>14,495</b>	
Loans	8,491	7,136	3,474	554	
<b>Capital Employed</b>	<b>16,657</b>	<b>16,681</b>	<b>15,867</b>	<b>16,202</b>	
<b>Net Fixed Assets</b>	<b>2,165</b>	<b>1,790</b>	<b>2,754</b>	<b>2,768</b>	
Capital WIP	1,485	1,071	400	400	
Investments	125	316	316	316	
<b>Curr. Assets, Loans &amp; Adv.</b>	<b>15,990</b>	<b>17,267</b>	<b>16,641</b>	<b>17,577</b>	
Inventory	2,601	3,044	3,409	3,615	
Sundry Debtors	6,289	5,687	5,321	5,243	
Cash & Bank Balances	1,886	1,287	1,665	1,914	
Loans & Advances	5,214	7,250	6,246	6,806	
<b>Current Liab. &amp; Prov.</b>	<b>3,534</b>	<b>4,000</b>	<b>4,480</b>	<b>5,096</b>	
Sundry Creditors	2,575	2,699	3,038	3,508	
Other Liabilities	97	71	90	100	
Provisions	861	1,229	1,352	1,488	
<b>Net Current Assets</b>	<b>12,456</b>	<b>13,267</b>	<b>12,161</b>	<b>12,481</b>	
Misc. Exps.	426	237	237	237	
<b>Appl. of Funds</b>	<b>16,657</b>	<b>16,681</b>	<b>15,867</b>	<b>16,202</b>	

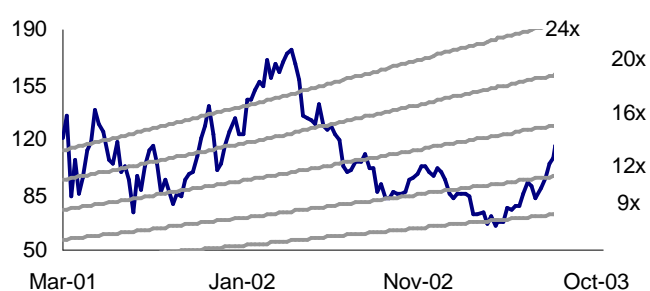
E: Inquire Estimates

RATIOS					
Y/E MARCH	2002	2003	2004E	2005E	
<b>Basic (Rs)</b>					
<b>EPS</b>	<b>4.7</b>	<b>6.0</b>	<b>7.3</b>	<b>8.6</b>	
Cash EPS	5.2	6.8	8.8	10.2	
Book Value per Share	19.6	20.3	27.3	35.1	
DPS	0.6	0.7	1.0	1.4	
Payout (Incl. Div. Tax) %	1165.9	1286.3	1267.8	1463.7	
<b>Valuation</b>					
P/E	29.1	22.8	18.8	16.0	
Cash P/E	26.2	20.3	15.7	13.5	
EV/EBITDA	20.8	16.6	12.8	10.3	
EV/Sales	5.9	5.2	4.2	3.5	
Price/Book Value	7.0	6.8	5.0	3.9	
Dividend Yield (%)	0.4	0.5	0.7	1.0	
<b>Profitability Ratios (%)</b>					
RoE	24.0	29.7	30.6	27.5	
RoCE	24.0	27.3	32.6	35.2	
<b>Turnover Ratios</b>					
Debtors (No. of Days)	213	172	140	120	
Inventory (No. of Days)	123	133	134	125	
Creditors (No. of Days)	180	167	165	165	
Working Capital (No. of Days)	422	401	320	286	
Asset Turnover (x)	0.6	0.7	0.9	1.0	
<b>Leverage Ratio</b>					
Debt/Equity (x)	1.0	0.9	0.3	0.0	

STOCK PERFORMANCE (1 YEAR)



PER BAND



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