

SCS	India Technology Investments
India – Media Sector	Feb 2000
MAGNASOUND INDIA LTD. (Rs 50)	SUBSCRIBE

The ZEE TV of Indian Music

- Magnasound India is a professionally managed Indian music production company. Magnasound has been in the business since 1991 and has established a unique brand in the US\$400m Indian Music Industry. Magnasound has an outstanding track record in artiste and repertoire development and promotion in the non-film music genre; over sixty “Platinum & Gold” Magnasound titles bear testament to the potential and delivery capabilities of the company.
- The Indian Music Industry has thrown some serious business challenges over the years and music software suppliers have experienced losses and bankruptcies (ABCL and Time Audio), Magnasound armed with a current repertoire of over 1200 albums has managed to remain profitable largely due to its non-exposure to film-based music.
- Magnasound plans to strengthen its position in the industry via a product broad basing, business de-risking and a financial restructuring strategy. The company plans solidify its regional pop music exposure, increase its geographic spread deeper into Indian states. The company has also outlined blueprint for debt reduction of Rs48m and for margin expansion via institutional sales and cross selling of artistes. Institutional Sales is expected to contribute 12% of Sep00 Revenues from Nil in Sep99. We expect pre-tax margins to improve dramatically from 1.5% in Sep99 to 13% in Sep00.
- We expect a three-year 40.6% CAGR in revenues from Sep99 and Sep01. We expect MIL's Sep00 and Sep01 ROE's to be steady at 17.0% and 18.7%. We expect factors such as the professional workflow, new business initiatives and strong EPS CAGR of 109.1% from Rs0.9ⁱⁿ in Sep99 to Rs8.3 in Sep01 to lead to a premium valuation of the Magnasound brand. SUBSCRIBE Price Target Rs150.

Results and estimates

Year-end 30-Sep	Revenue (Rs m)	Net profit (Rs m)	Chg (%)	EPS (Rs)	Chg (%)	P/E (x)	FV/EBITDA (x)	P/CE
Sep99A*	263.6	3.7	37%	0.9**	10.0%	55.4	12.8	22.7
Sep00E	577.2	60.7	1549%	6.1	1626%	5.5	11.1	7.4
Sep01F	733.1	82.5	36%	8.3	45%	6.1	3.3	5.5

^a In millions. ITI Estimates & Company prospectus. Source: ITI. * - 18 months ending September '99. ** - Annualized.

Key data

Mkt. Cap: Rs 500m / USD 11.6m	Current Issued shares: 3.3m Post-Issue Shares O/s: 10.0m	52-week avg. daily volume: N/A	Reuters code: N/A
Exchange rate: 43	52-week price range: N/A	Shareholder Data: Promoters- 55%; ESOP-3%; Others-17%;IPO- 25%.	Bloomberg code: N/A

KEY INVESTMENT CONSIDERATIONS

1,240 Album Library, 320 Artistes and counting...	Promoted by its present chairman and managing director Shashi Gopal in 1991, Magnasound India is a pioneer of the non-film genres of music. The ability of Magnasound in identifying, nurturing, promoting and marketing fresh talent provides the platform for a low-cost building of a library over and above the 1,240 albums across varied non-film music genres from over 320 artistes spread over the Indian geographies. Recently Magnasound has broken through a new category of consumers through its tie-up with Baron Electronics-a leading music hardware agency representing major Japanese electronic manufacturers. We expect strong revenue CAGR of 40.6% from Sep99 to Sep01.
Professional Work-Style due to past relations with BMG, Warner Bros., EMI etc....	Magnasound was erstwhile associated with leading international labels such as BMG, Warner Bros and EMI, while the business relations no longer continue it has been a key factor enabling the professionalism in the company. Magnasound has a strong management team comprising of experienced and industry veterans. The company has been recognized by the Indian Music Industry for its professional workflow methods. This is reflected in its processes and capabilities of identifying talent and further the image as well as brand value of an artiste. Blockbuster artistes such as Colonial Cousins, Alisha, Daler Mehndi, etc. are a testament to the capabilities and indicators of the future potential of the company.
Uniquely positioned in the trend-driven, less- price sensitive end of Indian music market...	Magnasound has carved out a niche focus area in the Indian Music Industry. Magnasound has a 7% marketshare of the film and non-film Indian Music Market. The company has minimal competition in its area of business, while competition has cropped up, they are either facing losses or have shut shop. The company has consciously targeted the non-film music genres and promotion of fresh talent on a parallel track with some big-ticket music artistes. Magnasound caters thus to a trend-driven youth that are less price sensitive and are exercising unprecedented spending behaviour in recent times. The uniqueness of catering to such a market is that promotion costs of releasing an album are low and holds an advantage of an early breaking even.
Historical performance is poor...	Investments into the building up of music library, demanding dealers/retailers and interest costs have taken a toll on the financial health. Magnasound had a poor after tax earnings margin of 1.6% in FY98 and 1.4% Sep99. We believe that with improved economies of scale margins are slated for a smart recovery to 10.5% in FY00 to 11.3% in Sep01.

INDUSTRY OUTLOOK

Indian Music scenario vis-à-vis the world

The Indian music industry is a highly fragmented and low priced market. India is ranked 2nd globally by volume, however it accounts only for 1% of the market by value. The same has been due to the collective effects of lack of professionalism, illegitimate sales and restrictions on imports and investment. With the arrival of International and professional labels who are drawn by the large numbers, the Indian music industry is undergoing an expedited transition with new ideas, practices and tapping of regional opportunities. Indian market has, in contrast to the global stagnancy, grown from a Rs9.56b in FY95 to Rs12.3b in FY98.

Film and Non-film gamble

Market Type	Mkt. Share	Consumer Attributes	Risk profile
Hindi Films	68%	Trend-Driven, low attention time and highly price sensitive	High Investment, Make-or-Break risk levels
Indipop	10%	Trend-Driven, enjoy film music but less price sensitive	Low-Investment, early break-even
International	2%	Educated, better purchasing power.	Medium - High Investment, longer break-even
Others	20%		

Film-based music is a crowded and highly big-ticket segment and the risk levels have taken their toll as many players attracted by the recent successes have announced bankruptcy and auctioned their repertoire. Moreover the segment being highly price sensitive the market is flooded with poor quality cassettes for maintaining margins and has very low CD Sales. Indipop, a genre of music coined by MIL, on the other hand is targeted to a more discerning in quality and less price sensitive audience. The company has leveraged this bracket to even push through CD offerings. Magnasound has a competitive CD-cassette pricing ratio of 4.73:1 given that the competition has a ratio of 4.63:1. The international norm for this ratio is typically 1.5:1, thus indicating ample scope for price increase in cassettes and CD volume growth via price reduction.

Hardware penetration and Retail explosion drivers for growth

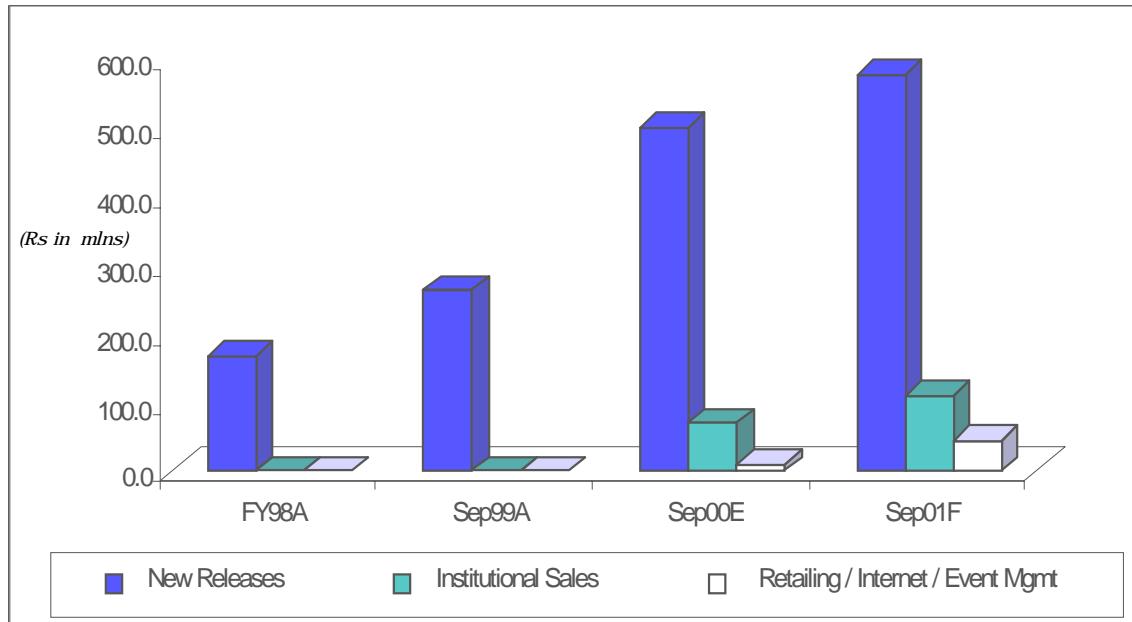
Price-wars and increased hard-sell in the music hardware market amongst players such as Aiwa, Akai, Sansui, Phillips, Sony, Kenwood etc. has resulted into an unprecedented volume creation of fresh music consumers, moreover being superior quality hardware, quality music software or CD Sales have received an impetus. We believe that hardware penetration has been only recently initiated and is yet to percolate down through the non-metro geographies of India, as a result the future consumers pipeline remains strong. Enabling the consumer behavior is the retail revolution currently underway in the metros in India, Mom & Pop outfits with 200-300 sq. ft of shelf space are giving way to Megastores of the nature of US departmental stores. The consequent increase in shelf-space alongwith an improvement in the shopping experience is expected to shift demand patterns to better quality cassettes, CD's and music software.

Music Piracy on a downtrend

The uptrend in lifestyle has positively effected legitimate sales of cassettes and CDs, also recent efforts of industry associations as well as the Anti-Piracy Council consisting of ex-Police Commissioners has made significant strides in clamping down on the fly-by-night operators and confiscation of pirated material.

BUSINESS DIVISIONS

Magnasound India Ltd. has a mix of three distinct yet synergistic business units. The trend emerging from the ongoing business mix transition is discussed below –



New Music Releases – (86% of Sep00 Revenues)

Magnasound has built a library of 1,240 music albums rendered by a diverse set of 320 artistes. The company has over 60 “Platinum or Gold” artistes amongst its performer pool. Thus the company enjoys a very high success ratio of approximately 1 successful artiste for every five on its roster. This ratio for film-based music is almost 1 successful soundtrack for every 10 failed films. Moreover the costs of acquiring, managing and promoting an original film soundtrack are multifold than that for artist development. Magnasound has a stellar track record in Artiste and Repertoire management, most of the recent and popular non-film artistes such as Colonial Cousins, Daler Mehndi etc. are for the Magnasound stable. This is largely attributed to personal involvement of the chairman in the artiste and repertoire selection process, as well as the preparation of a detailed cost-benefit analysis and image/brand building blueprint. New releases division is a key business unit as it is the supply end of the business; other business units are all delivery units. The company has an excellent talent farming system in place; the low cost library thus created has enabled Magnasound to achieve a significant barrier to entry. Fair estimates for building such a library put a bill of atleast Rs100-200m in cash excluding the costs for all other peripheral business requirements. The company has outlined almost Rs124.4m towards purchase and acquiring of new titles as part of its regionalization program.

We expect revenues from the division to grow from Rs263.6m in Sep99 to Rs501.6m in Sep00 and Rs577.5 in Sep01 at a CAGR of 29.9%. Although this is at a slower rate of growth than that of total sales, we expect a significant margin expansion due to economies of scale and moreover addition of newer business streams such as Institutional Sales, Retailing, Event Management and Internet. These are also expected to occupy an increasingly visible chunk of total revenues going forward.

Institutional Sales - (12% of Sep00 Revenues)

The new paradigm in the Magnasound business model, the company has recently broken through a new spectrum of consumers via a tie-up with Baron Electronics. Baron is the marketing agent for leading Japanese music systems and has been recognized for generating explosive sales volumes via unique promotions. Baron, Business Standard have selected the Magnasound catalogue as a promotion exercise for marketing their products. Magnasound is grabbing the opportunity of exploiting this hardware penetration and increasing catalogue sales. Critically slow-moving inventory is being disposed off as it is packaged alongwith it's more popular music software. We believe that even co-branding with popular brands will be exploited going forward.

The business advantage of Institutional sales arises from the mix of strong volume generation, catalogue sales and most importantly an improved receivables position compared to similar sales to dealers / retailers. An important aspect of revenues accruing from this division is that they largely flow directly into the bottomline, as the monies received are in the form of fees towards which there are only corresponding duplication costs. We expect revenues from this division to drive after tax earnings margin from 1.4% in Sep99 to 13.3% in Sep00.

Retailing, E-tailing and Event Management - (1% of Sep00 Revenues)

Magnasound has outlined a host of new and potential business streams. Magnasound has earmarked Rs32.8m for the retailing venture; we believe that with the retail revolution underway the same holds a significant upside potential. However given the long gestation periods for the setting up and development of a mega-outlet, we estimate revenues from the same to flow only from Sep01 onwards. We expect retailing revenues of Rs12.2m or 1.6% of Sep01 revenues. The company has outlined setting up of three outlets initially in Sep01 increasing by additional three outlets in each fiscal year. We expect the investment to be targeted solely for the first round of retail outlets; the additional expansion will be funded through internal accruals of the company. Internet E-tailing on the other hand will be a valuation driver for the company in the short-term, over the long run however we expect e-revenues of Rs15.6m in Sep02. The company already has an ongoing effort in the form of www.music-from-india.com, which is an on-line music offering of Magnasound titles; the same can be compared to www.saregama.com.

Event Management, we expect will provide the distinguishing factor to Magnasound vis-à-vis the rest of the music industry. While bringing together a pool of film-based actors and stars for an event is a herculean task, the same event for a non-film based artist is an easier affair, especially for Magnasound for whom the artistes are on a contract for a minimum of three years. The company gains from the artist and audience interaction, which further fuels the album sales. Although the above businesses are expected to contribute to the revenues only in Sep01, we expect the event management to begin contributing from Sep00 to the tune of Rs4m steadily increasing to Rs8.8m in Sep01.

In-House Post Production Studio

Magnasound has outlined an investment of Rs20m for a post-production studio. The company currently outsources this activity from other post-production studios. We expect an average saving of Rs0.3m per album to materialize with the in-house utilization of such a facility. At an assumption of atleast 35 videos per annum, we expect this division to become cashflow positive from Sep01 onwards.

EARNINGS STATEMENT

Yr. to Sep (Rs mlns)	FY98*	Sep99A**	Sep00E	Sep01F
Revenues				
New Release Revenues	168.4	263.6	577.5	669.9
Export Sales	0.0	0.0	7.8	10.9
Institutional Sales	0.0	0.0	111.2	234.7
Retailing / Event Mgmt.	0.0	0.0	21.0	43.3
Internet Sales	0.0	0.0	0.0	15.6
Net Operating Inc.	168.4	263.6	733.1	980.6
Other Income	2.5	25.1	0.0	0.0
Total Income	170.9	288.6	733.1	980.6
Prod. & Dupl. Exp.	43.6	106.3	248.1	310.0
Recording/Master/Video	42.1	51.3	110.4	137.8
Mktg. & Admin. Expenses	46.4	58.7	98.2	147.4
Others	23.4	32.1	23.9	25.1
Total Operating Exp	155.5	248.4	480.6	620.3
Operating Income	12.9	40.2	100.6	112.8
Financial Charges	9.9	32.8	18.9	0.0
Depreciation	2.5	3.5	6.6	9.1
Pre-tax Profit	3.0	4.0	75.1	103.7
Tax	0.4	0.3	14.4	21.2
Net Profit	2.7	3.7	60.7	82.5

BALANCE SHEET

Yr. to Sep (Rs mlns)	FY98*	Sep99A**	Sep00E	Sep01F
Share Capital	32.6	32.6	100.0	100.0
Share Application	0.0	0.0	180.0	0.0
Reserves and Surplus	13.2	16.9	77.6	340.1
Shareholder's Funds	45.8	49.5	357.6	440.1
Secured Loans	24.9	48.0	0.0	0.0
Unsecured Loans	2.0	0.0	0.0	0.0
Total Loan Funds	26.9	48.0	0.0	0.0
Total	72.7	97.5	357.6	440.1

Application of Funds

Gross Block	19.6	20.7	87.9	124.0
Depreciation	8.5	10.6	18.6	27.7
Net Block	11.1	8.6	69.3	96.3
Work in Progress	37.4	46.2	119.3	171.5
Net Fixed Assets	48.5	54.8	188.6	267.8

Investments	0.0	0.0	0.0	0.0
Current Assets, Loans and Advances	151.5	172.7	425.8	518.0
Inventories	42.5	45.6	65.3	100.3
Debtors	83.7	85.3	195.5	223.1
Cash and Bank	1.1	1.5	74.7	95.2
Other current Assets	0.0	0.0	0.0	0.0
Loans and Advances	24.1	40.3	90.3	114.3
Current Liabilities	127.4	130.1	256.9	345.7
Provisions	0.0	0.0	0.0	0.0
Net Current Assets	24.1	42.6	233.9	319.7
Miscellaneous Exp	0.1	0.1	0.1	0.1
Total	72.7	97.5	357.6	440.1

CASHFLOW STATEMENT

Yr. to Sep (Rs mlns)	FY98*	Sep99A**	Sep00E	Sep01F
Sources of Funds				
Net Profit	2.7	3.7	60.7	82.5
Depreciation	2.5	3.5	6.6	9.1
Inc / (Dec) in Equity Capital	32.6	0.0	67.4	0.0
Inc / (Dec) in Share Premium	0.0	0.0	180.0	0.0
Inc / (Dec) in Loan Funds	26.9	21.1	(48.0)	0.0
Inc / (Dec) in Current Liabilities	127.4	2.7	126.8	100.0
Inc / (Dec) in Provis	0.0	0.0	0.0	0.0
Total	192.1	31.0	393.4	180.4
Applications of Funds				
Dividends	0.0	0.0	0.0	0.0
Tax on dividend @ 10%	0.0	0.0	0.0	0.0
Inc / (Dec) in Gross Block	19.6	1.0	67.2	36.1
Inc / (Dec) in CWIP	37.4	8.8	73.1	52.2
Inc / (Dec) in Invst	0.0	0.0	0.0	0.0
Inc / (Dec) in Inventories	42.5	3.1	19.7	20.0
Inc / (Dec) in Debtors	83.7	1.6	110.2	27.6
Inc / (Dec) in Other Current Assets	0.0	0.0	0.0	0.0
Inc / (Dec) in Loans & Adv.	24.1	16.2	50.0	24.0
Inc / (Dec) in Misc. Exp.	0.1	0.0	0.0	0.0
TOTAL	207.5	30.6	320.3	159.9
Op cash bal	16.5	1.1	1.5	74.7
ADD / (Deficit)	-15.4	0.4	73.2	20.5
Cl bal of cash	1.1	1.5	74.7	95.2

KEY RATIOS

Yr. to Sep	FY98*	Sep99A**	Sep00E	Sep01F
Business Growth				
Sales growth	1.4%	56.6%	120.5%	26.1%
New Release business	0.0%	56.6%	90.3%	15.1%
Institutional business	0.0%	0.0%	4300.0%	58.9%
Operating Profit growth	128.6%	32.6%	560.4%	12.1%
Earnings growth	400.0%	12.4%	1549.0%	35.9%
Margins				
Operating margins	7.7%	5.8%	17.3	15.4
Pre-tax Margins	1.8%	1.5%	12.9	14.1
Net Profit Margins	1.6%	1.4%	10.4	11.3
Profitability				
Return on Equity	5.9%	7.4%	17.0%	18.7%
Return on Assets	3.7%	3.8%	17.0%	18.7%

P/E Sensitivity

Yr. To Sep	FY98*	Sep99A**	Sep00E	Sep01F
EPS	0.8	0.9	6.1	8.3
10x	8.2	9.0	60.7	82.5
20x	16.4	18.0	121.4	165.0
30x	24.6	27.1	182.1	247.5
40x	32.8	36.1	242.8	330.0
50x	41.0	45.1	303.5	412.5
60x	49.2	54.1	364.2	495.0

PERx (at various prices)	FY98*	Sep99A**	Sep00E	Sep01F
Price				
Rs 50	61.0	66.5	4.0	2.7
Rs 60	73.1	79.8	4.8	3.3
Rs 80	97.5	106.4	6.4	4.4
Rs 100	121.8	133.0	8.0	5.5
Rs 120	146.2	159.6	9.5	6.6

* - Yr. Ending 31st March; ** - 18 months period.