

CAS...long term positive

Stock Market Data

BSE Code	505537
BSE Index	3097
AvgDailyVol	5m
52 W. H/L	155/60

Shareholding Pattern

Promoters	52%
MFs/ UTI	6%
Banks/ FIs	1%
FII's	27%
Corporate Bodies	3%
NRIs/ OCBs	1%
Foreign Comp.	1%
Indian Public	10%

Key Data

Market Cap., Rsm	32170
Issued Shares, mn	412
PBR- FY04F	2.6
Next Result	Q1FY04E

Brief Financial -

Rsm	FY02	FY03	FY04E
Rev.	10763	11993	13308
PAT	1946	2270	3008
% Chg	6%	36%	32%
EPS, Rs	4.7	5.5	7.3
PE, x	16.5	14.2	10.7
OPM, %	28%	32%	33%
ROE, %	25%	27%	24%

May 26th, 2003

CAS...Successful implementation is the key

We believe successful implementation of 'Conditional Access System- CAS' would be the key for future valuation of broadcasting industry. While 'Multi System Operators- MSOs' would be the immediate beneficiary, Pay revenue will take beating in the short run to turn positive 3 years down the line, according to us. The drop in Advertising Revenue, we expect 10% drop in Ad revenue in FY04E, will be compensated through expected higher Siticable and Pay revenue in the longer run.

Siticable (MSO)...immediate beneficiary

We conservatively estimate 10% households conversion to 'Set top boxes-STBs' in the first year of CAS implementation to improve upto 60% within next 5years. Post-CAS, we expect Siticable revenue from metro cities to almost double to Rs832m in the first 8 months of implementation. Post-CAS, Siticable revenue from metro cities is expected to improve at a CAGR of 29% to Rs2.3bn through FY08F.

Pay Revenue...long term positive

We do not expect impact on pay revenue to be as severe, as the revenue stream is linked to the household declaration in pre-CAS regime and not actual reach, which is close to our expected conversion ratio post-CAS. We expect change in pay revenue to turn negative in the first three years of CAS implementation, and expected to be positive 3/4 years down the line of implementation.

Ad Revenue...negative

We expect post-CAS change in advertising revenue to be negative as a result of dropped channel penetration. Although the improvement in Ad revenue in the long run is imminent after an initial drop, expected change should be negative.

CAS...overall positive

We believe CAS would turn out to be positive in the long run provided the availability, affordability and financing issues of STBs and pay channels get resolved before launch. With the successful implementation, the drop in advertisement revenue would be compensated with the improved earnings from Siticable and pay channels with 100% declaration.

Valuation...looks attractive

Company has improved its receivable position from 213 days in FY02 to 171 days in FY03 and further planned to 140-145 days in FY04E. The total debt has come down to Rs7.4bn in FY03 from last year's Rs8.5bn. Company plans to reduce it further going forward. We haven't considered CAS effect in our earnings calculations as a result of looming uncertainty though we expect positive impact in the long run. We expect, without considering CAS effect, revenue and earnings to improve by 11% and 32% to Rs13.3bn and Rs3bn in FY04E. At CMP, the stock is quoting at 10.7x, FY04E earnings. We reiterate **BUY**.

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Siticable...immediate beneficiary

CAS- positive to MSOs We expect Siticable revenue to grow at a CAGR of 29% to Rs2.3bn in metro cities through FY08F and the revenue upside of Rs1.3bn, through FY08F.

Free-to-air channels- FTA We expect a surge in Siticable revenue as a result of share in FTA channels to grow at a CAGR of 22% going forward to Rs1.8bn through FY08F.

Revenue from FTA channels - Basic tier

	FY04E*	FY05F	FY06F	FY07F	FY08F
Siticable Reach, mn	5.5	5.8	6.1	6.4	6.7
% in Metro Cities	50%	50%	50%	50%	50%
Reach in Metro Cities, mn	2.8	2.9	3.0	3.2	3.3
Basic Tier Rate, Rs	72	76	79	83	88
Share to Siticable, 50%	36	38	40	42	44
Total Rev., Rsm/yr	792	1310	1444	1592	1755

Share in Pay revenue Share in pay revenue for Siticable is expected to grow at a CAGR of 91% to Rs527m through FY08F in metro cities.

Share in Pay channel revenue

	FY04E*	FY05F	FY06F	FY07F	FY08F
Siticable Reach, mn	5.5	5.8	6.1	6.4	6.7
Reach in Metro Cities	50%	50%	50%	50%	50%
STB adaptability, %	10%	20%	30%	45%	60%
Households with STBs	0.28	0.58	0.91	1.43	2.01
Pay Channel Charges, Rs	180	189	198	208	219
To MSOs, 10%	18	19	20	21	22
Fee to Siticable, Rsm/yr	40	131	217	358	527

Total Siticable- Post-CAS

Immense revenue upside We expect CAS implementation would offer immediate revenue upside for the Siticable and post-CAS revenue to grow at a CAGR of 29% to Rs2.3bn through FY08F in metro cities. We believe going forward Siticable would drive Zee's valuation.

Rsm	FY04E	FY05F	FY06F	FY07F	FY08F
With CAS	832	1441	1661	1950	2282
Without CAS	901	1486	1635	1799	1979
Revenue from Metro, 50%	450	743	818	899	989
Revenue Upside	381	698	843	1051	1293

FY04E: figures for 8months (Aug03-Mar04)

Pay revenue...long term positive

Pay revenue -short term negative

Post-CAS implementation pay revenue has to come down not only for Zee but also for all pay channels, as penetration would drop drastically. We expect change in pay revenue would remain negative for next three years before turning positive through FY07F.

Pay revenue - linked to declaration not reach

As pay revenue linked to declaration by LCOs, which is close to our expected CAS penetration, we expect drop in pay revenue shouldn't be as severe as expected by the market.

Pay revenue- Metro cities, post-CAS

	FY04E*	FY05F	FY06F	FY07F	FY08F
C&S reach in Metros, mn	6.2	6.5	6.8	7.2	7.5
STB adaptability, %	10%	20%	30%	45%	60%
Households with STBs	0.62	1.30	2.05	3.23	4.52
Zee Bouquet Price, Rs	55	58	61	64	67
Share of Broadcaster @40%	22	23	24	25	27
% Households with Zee Bouquet	75%	75%	75%	75%	75%
Households with Zee Bouquet	0.47	0.98	1.54	2.42	3.39
Pay Rev, in metros, Rsm/yr	82	271	448	740	1088

Pay revenue- Metro cities, pre-CAS

	FY04E*	FY05F	FY06F	FY07F	FY08F
C&S reach in Metros, mn	6.2	6.5	6.8	7.2	7.5
Declaration	15%	17%	19%	21%	23%
Declared Households, mn	0.93	1.1	1.3	1.5	1.7
Zee's Avg Rev/household, Rs	33	35	36	38	40
Total Pay Rev/ yr, Rsm	246	460	567	691	834

Pay revenue upside, post-CAS

	FY04E*	FY05F	FY06F	FY07F	FY08F
Post-CAS	82	271	448	740	1088
Without CAS	246	460	567	691	834
Revenue Upside	-164	-189	-119	49	254

FY04E: figures for 8months (Aug03-Mar04)

Assumption - We expect subscriber to subscribe whole bouquet of Zee and not 2/3 channels, as it would turn out to be cheaper. (Annexure 1)

Advertisement revenue...negative

Advertisement revenue-linked to reach

Advertising rates and no of advertisements on any channels are directly linked to reach. Zee has declared to remain pay post-CAS, which would drop its reach in metro drastically. The lower reach will translate into lower Ad rates and less no of advertisements, which should bring down advertising revenue by atleast 10%, according to us. Although we expect advertising revenue to improve gradually thereafter, it shouldn't surpass pre-CAS level in near future, as we do not expect 100% STB and Zee's pay channel reach in CAS regime.

Change in advertising revenue

	FY04E*	FY05F	FY06F	FY07F	FY08F
Post-CAS					
Change in Ad Revenue, %	-10%	5%	10%	10%	10%
New Ad Revenue	4017	6327	6960	7656	8422
Pre-CAS					
Ad Revenue, Rsm	4464	7030	7733	8507	9357
Change in Ad Revenue, Rsm	-446	-703	-773	-851	-936

FY04E: figures for 8months (Aug03-Mar04)

CAS...total revenue effect

Revenue upside, post-CAS

In the long run, we expect CAS would turn out to be positive for Zee as a result of surge in Siticable revenue. The negative change in the advertising revenue and pay revenue in initial years would offset by the surge in the Siticable revenue 3/4 years down the line.

Rsm	FY04E*	FY05F	FY06F	FY07F	FY08F
Revenue upside to Siticable	381	698	843	1051	1293
Pay Revenue upside	-164	-189	-119	49	254
Ad Revenue Change	-446	-703	-773	-851	-936
Net Revenue Upside	-229	-195	-50	250	611

FY04E: figures for 8months (Aug03-Mar04)

Valuation

We haven't considered any CAS effect as the situation is still uncertain and some issues like availability, affordability and financing of set-top-boxes and affordability of pay channels post-CAS have to be resolved before jumping on any conclusion, though we are positive about the long-term effect of CAS on broadcasting industry.

**Valuation: Looks
attractive**

Company has improved its receivable position to 171 days in FY03 from 213 days in FY02 and expected to improve it further to 140-145 days. Also reduced debt, Rs7.4bn in FY03 from Rs8.5bn in FY02, has brought down finance cost in FY03 by Rs44m and is expected to come down further. Cost control measures helped company to improve operating margin by 370 basis points to 32%. We expect OPM to further improve to 33% in FY04E. At CMP, the stock is attractively trading at 10.7x, FY04E earnings and 2.6 PBR. We reiterate **BUY**.

Income Statement

Rsm	FY01	FY02	FY03	FY04E
Earnings				
Sales	9573	10763	11770	13053
ETC (51%)	0	0	223	255
Op. Inc.	9573	10763	11993	13308
Expenses				
Content	2350	2493	2746	3018
Broadcasting	1120	895	784	850
Distribution	852	1047	1096	1200
Employees	608	778	715	725
SG & A	2294	2507	2692	2950
ETC (51%)	0	0	125	143
Total Exp.	7224	7721	8158	8886
EBITDA	2349	3042	3835	4422
Other Income	586	792	773	800
Gross Profit	2935	3834	4608	5222
Interest Exp	552	808	764	550
Depreciation	154	215	303	375
PBT	2229	2811	3541	4297
Tax	394	865	885	1289
PAT	1835	1946	2656	3008
W/off			386	
Adjusted PAT	1835	1946	2270	3008

Key Ratios

Yr To Mar	FY01	FY02	FY03E	FY04F
Mcap To Sales(x)	3.4	3.0	2.7	2.4
Sales To Gross(x)	4.0	3.6	2.6	2.4
Debtors Days	114	213	171	145
Inventory Days	150	88	88	88

Ratios

	FY01	FY02	FY03E	FY04F
Growth				
Income	23%	12%	11%	11%
Earnings	14%	6%	36%	32%
Margin				
OPM	25%	28%	32%	33%
NPM	13%	11%	16%	17%
Return				
ROE	30%	25%	27%	24%
ROA	14%	12%	15%	16%

Sales Breakup

	FY01	FY02	FY03E	FY04F
Advertising	71%	61%	52%	50%
Subscription	21%	29%	40%	42%
Others	8%	9%	6%	6%
ETC	0%	0%	2%	2%

Balance Sheet

Rsm	FY01	FY02	FY03E	FY04F
Liability				
Equity Capital	412	412	412	412
Reserves	5721	7346	9306	12004
Total NW	6133	7758	9719	12416
Loans	7049	8491	7370	5370
Minority Interest	0	3	1015	1015
Total Liability	13182	16253	18104	18801
Assets				
Gross Block	2378	2950	4574	5474
Depreciation	462	763	1066	1441
Net Block	1916	2187	3508	4033
CWIP	282	1485	1500	1600
Net Fixed Inve.	2198	3672	5008	5633
Investment	390	125	140	150
Current Assets	13928	15990	16706	17093
Inventory	3931	2601	2900	3200
Debtors	2991	6289	5620	5300
Cash	1755	1886	1460	2500
Loans & Adv	5079	5214	6726	6093
Other Assets	172	0	0	0
Current Liability	3334	3534	3750	4075
Net C. Assets	10594	12456	12956	13018
Total Assets	13182	16253	18104	18801

Price Sensitivity

Yr To Mar	FY01	FY02	FY03	FY04E
Price/EPS	4.4	4.7	5.5	7.3
50	11.2	10.6	9.1	6.9
60	13.5	12.7	10.9	8.2
70	15.7	14.8	12.7	9.6
80	18.0	17.0	14.5	11.0
90	20.2	19.1	16.4	12.3
100	22.5	21.2	18.2	13.7

PE Sensitivity

Yr To Mar	FY01	FY02	FY03	FY04E
PE/EPS	4.4	4.7	5.5	7.3
5	22	24	28	36
7	31	33	39	51
9	40	42	50	66
11	49	52	61	80
13	58	61	72	95
15	67	71	83	109

Annexure 1

Zee Bouquet Price, post-CAS

Channel	Rs
Zee TV	30
Zee Cinema	20
Zee News	20
Zee MGM	20
Zee English	20
Cartoon Network	20
Reality TV	15
Trendz	15
CNN	15
CNBC	15
Alpha Punjabi	15
Alpha Bengali	15
Alpha Marathi	15
Alpha Gujarathi	15
Zee Music	15
ETC Punjabi	15
Etc Hindi	15
Entire Bouquet Price	55

Revenue Sharing

Rs	Basic Charge	Pay TV Charge	Total Sub
	72	180	252
LCO, 50% of Basic, 15% of Pay TV	36	27	63
MSO, 50% of Basic, 10% of Pay TV	36	18	54
Broadcaster, 40% of Pay TV		72	72
Infrastructure Provider, 15% of Pay TV		27	27
SMS JV, 10% of Pay TV		18	18
Marketing, 10% of Pay TV		18	18
Total	72	180	252