

SELL Zee Entertainment

Your success is our success

Merger hits a dead end; downgrade to SELL

Media & Entertainment ▶ Company Update ▶ January 23, 2024

TARGET PRICE (Rs): 175

In a major setback for Zee, its proposed merger with Sony India has been called off after Sony sent a termination letter, putting an end to the tumultuous journey of over two years. This termination is despite Punit Goenka agreeing to step down as the MD & CEO of the merged entity, as per Zee. As highlighted earlier (in our note: [Potential breakdown on the cards](#)), we believe this situation is a lose-lose for both players, particularly in the face of competition from the bigger potential entity Reliance-Disney. The termination should also result in a legal tussle between the two embroiled companies, as implied in their press release. We believe this breakdown can also spur shareholder activism against Zee Management. Further, we reckon that Zee will now draw other suitors for potential deals. Currently, we downgrade the stock to **SELL (from Buy) due to weak competitive positioning and escalated corporate governance issues. We pull our TP down to Rs175 at 8x Dec-25E SA broadcasting EBITDA (from Rs315; 9.5x pro-forma broadcasting EBITDA).**

Zee Entertainment: Financial Snapshot (Consolidated)

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	81,893	80,879	86,620	89,128	96,316
EBITDA	17,221	11,011	9,845	17,894	20,581
Adj. PAT	11,016	5,811	4,430	10,657	12,640
Adj. EPS (Rs)	10.0	0.5	3.3	11.1	13.2
EBITDA margin (%)	21.0	13.6	11.4	20.1	21.4
EBITDA growth (%)	(3.8)	(36.1)	(10.6)	81.8	15.0
Adj. EPS growth (%)	20.6	(95.0)	567.3	234.2	0.0
RoE (%)	10.6	5.5	4.2	9.4	10.4
RoIC (%)	12.0	6.1	4.6	9.8	11.0
P/E (x)	20.5	38.8	50.9	21.2	17.9
EV/EBITDA (x)	12.4	20.2	22.9	12.4	10.7
P/B (x)	2.1	2.2	2.1	1.9	1.8
FCFF yield (%)	(0.6)	(0.9)	(2.8)	3.0	2.7

Source: Company, Emkay Research

Dead end for the merger; what next?

The Zee-Sony merger, which was slated to address investor concerns around governance, Board composition, and funding for future expansion, has now been called off. Zee has already refuted Sony's claims on breach of the merger co-operation agreement (MCA) and highlighted that it intends to explore all options, including resorting to legal recourse as well as contest Sony's arbitration claim proceeds of USD90mn. Reports have also indicated large institutional investors desiring an EGM which raises the probability of another possible long-drawn out legal tussle between investors and promoters (à la Invesco Oppenheimer, a couple of years ago). Going forward, we believe Zee will attract other suitors for potential deals, with 'going it alone' being a low-probability event, in our view. Sony would potentially look for other options in the market as well, having itself been unable to garner significant market share, with industry consolidation being highly likely going ahead.

On a weak footing operationally

Zee has faced challenges on the operational front over the last couple of years (advertising growth of -8% in FY23, -3.5% in H1FY24). Subscription growth was also impacted (in FY22 and FY23), owing to the pricing embargo surrounding NTO3.0 (implemented on 1-Feb-2023). Also, Zee's market share has been sticking to lower levels. EBITDA margin has declined, from 23.2% in FY21 to 13.6% in FY23. This breakdown also raises questions about the deal with Disney, for television broadcasting rights of ICC events; as such, it may not be able to justify a large capital commitment (Rs110-120bn, per our estimates) on a standalone basis. Zee5 has also been unable to capitalize on the OTT opportunity, having seen a slow-down in some key metrics as well as heightened losses. We believe the failure of the deal with Sony and the potential Reliance-Disney merger can further weaken Zee's position, leaving it at a vulnerable spot in the overall industry. We slash FY24-26E standalone EBITDA for Zee by 2-17%, to factor in the slower recovery, absence of sporting revenues, and the heightened content investments. The stock has traded at one-year forward EV/EBITDA of 17x over the last 10-years (our valuation adjusts for OTT losses), though it has seen significant de-rating over the last few years due to its weaker positioning. Zee would see more de-rating in our view, now that the merger has fallen apart.

Target Price – 12M	Dec-24
Change in TP (%)	(44.4)
Current Reco.	SELL
Previous Reco.	BUY
Upside/(Downside) (%)	(24.2)
CMP (19-Jan-24) (Rs)	231.0

Stock Data	Ticker
52-week High (Rs)	300
52-week Low (Rs)	170
Shares outstanding (mn)	960.5
Market-cap (Rs bn)	226
Market-cap (USD mn)	2,717
Net-debt, FY24E (Rs mn)	272
ADTV-3M (mn shares)	22
ADTV-3M (Rs mn)	5,728.0
ADTV-3M (USD mn)	69.0
Free float (%)	96.0
Nifty-50	21,622
INR/USD	83.1
Shareholding, Dec-23	
Promoters (%)	4.0
FPIs/MFs (%)	28.2/43.6

Price Performance

(%)	1M	3M	12M
Absolute	(13.5)	(9.4)	4.7
Rel. to Nifty	(14.2)	(17.8)	(12.3)

1-Year share price trend (Rs)**Pulkit Chawla**pulkit.chawla@emkayglobal.com
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What's the price building in?

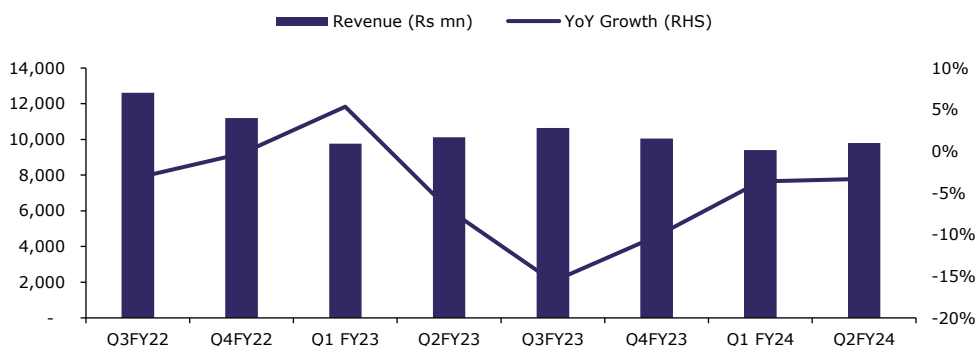
Zee's stock price has already corrected 20% in the last few weeks, as news of the merger falling through started doing the rounds. Despite this correction, we believe the stock can still see a sharp negative reaction in the near term. Emergence of a new partner/buyer would be the key trigger for re-rating of the stock, else we would remain negative on the stock. Our negative stance on the stock factors in the slower revenue growth on account of: i) shrinking share of television vis-à-vis digital; ii) no major sporting properties, limited funds for driving growth, and inability to curb OTT losses, even as revenue growth has also slowed down.

Exhibit 1: Select corporate governance issues of Zee

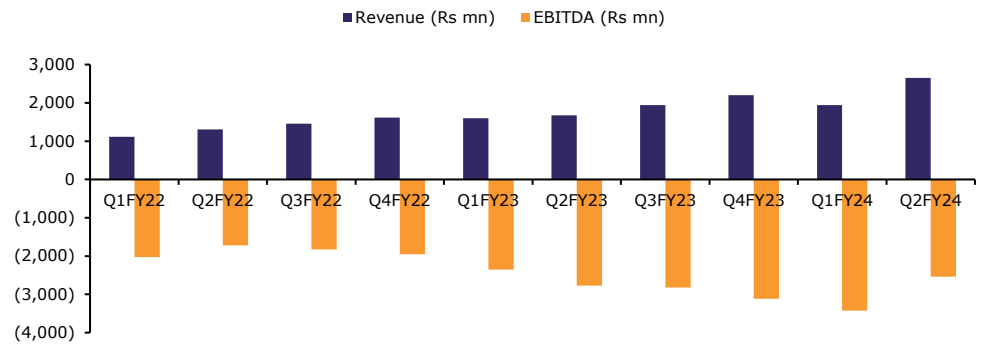
Issue	Latest Update
Punit Goenka and Subhash Chandra have been accused of siphoning off funds for their own benefits. The duo have been alleged to have provided a letter of comfort without consulting or informing the Board. As per SEBI, Zee is also found to have falsely claimed in its FY20 annual report that it had received all the funds from its associate entities.	SEBI had barred the duo from holding any directorial or managerial position which was later overturned by SAT. Investigation by the SEBI, however, remains ongoing.
Promoter Subhash Chandra, through Essel Infraprojects, took loans for which Zee shares were pledged which were then sold to institutional investors to clear promoters' debt.	Subhash Chandra resigned from the Board and was replaced by an independent director as the board chairman.
Invested in overseas mutual funds. Two of the high-yielding MFs turned out to be illiquid. The company booked a loss of Rs3.8bn in FY20.	The updated policy allowed the company to invest funds in bank FDs or in an MF scheme having a minimum Rs25bn AUM.
The company committed investment worth Rs5.2bn in Sugarbox, to set up public WiFi solutions.	Investment timelines shifted due to the pandemic. It has now written down investments worth Rs3bn at the end of Q1FY24.
ZEEL had issued an LoC to Yes Bank in connection with a borrowing by Living Entertainment (LEL), a related party. Subsequent to a default by LEL, Yes Bank called upon ZEEL to honor the obligation.	Status of the matter is sub judice in the court. No liability has been accrued towards this matter.
Allegations of irregularities around related-party transactions and film advances for content acquisition.	The independent firm did not find any evidence of any irregularities. Additional processes were strengthened. Two independent directors had resigned from the Board, citing inaction over several issues, including the Rs22bn content advance.
Pending receivables from Dish TV and Siti.	Receivables from Dish TV and Siti had been irregular, given the financial constraints for both companies. Siti defaulted on its loan of Rs4bn in October 2020; while Zee is collecting receivables from Dish which have been irregular.
ICDs receivable from related parties.	Rs1.7bn worth receivables written off in Sep-19.

Source: Company, Emkay Research

Exhibit 2: Zee's advertising growth has been sub-par over the last few years



Source: Company, Emkay Research

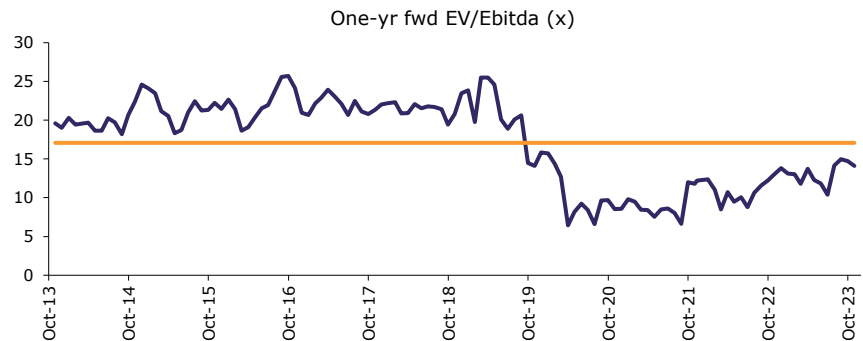
Exhibit 3: Zee5's EBITDA losses have increased despite revenue growth

Source: Company, Emkay Research

Exhibit 4: Zee5 – MAUs and DAUs have shown a moderation in growth

Zee5 (reported)	Q1FY21	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23
MAUs (mn)	40	55	66	43	80	93	102	105	103	112	120	114
DAUs (mn)	4	5	5	6	7	9	10	11	11	11	12	11

Source: Company, Emkay Research

Exhibit 5: Zee – One-year fwd EV/EBITDA

Source: Bloomberg, Emkay Research

Exhibit 6: Change in estimates

Particulars (Rs mn)	FY24E			FY25E			FY26E		
	Old	Revised	Change	Old	Revised	Change	Old	Revised	Change
Ad revenue	41,745	40,518	-2.9%	46,555	44,148	-5.2%	51,173	48,526	-5.2%
Subscription revenue	36,129	36,040	-0.2%	38,157	38,180	0.1%	40,564	40,590	0.1%
Revenue	87,536	86,620	-1.0%	90,312	89,128	-1.3%	97,737	96,316	-1.5%
EBITDA	11,827	9,845	-16.8%	18,763	17,894	-4.6%	21,179	20,581	-2.8%
EBITDA Margin (%)	13.5	11.4	-215 bps	20.8	20.1	-70 bps	21.7	21.4	-30 bps
PAT	4,770	3,189	-33.1%	11,308	10,657	-5.8%	13,237	12,640	-4.5%
EPS (Rs)	5.0	3.3	-33.6%	11.8	11.1	-6.0%	13.8	13.2	-4.7%

Source: Emkay Research

Zee Entertainment: Consolidated Financials and Valuations

Profit & Loss					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	81,893	80,879	86,620	89,128	96,316
Revenue growth (%)	5.9	(1.2)	7.1	2.9	8.1
EBITDA	17,221	11,011	9,845	17,894	20,581
EBITDA growth (%)	(3.8)	(36.1)	(10.6)	81.8	15.0
Depreciation & Amortization	2,459	3,128	3,685	3,841	4,060
EBIT	14,762	7,884	6,160	14,053	16,521
EBIT growth (%)	(3.2)	(46.6)	(21.9)	128.1	17.6
Other operating income	0	0	0	0	0
Other income	1,213	797	600	840	960
Financial expense	451	702	868	640	680
PBT	15,524	7,979	5,892	14,253	16,801
Extraordinary items	(1,370)	(5,333)	(1,241)	0	0
Taxes	4,597	2,167	1,460	3,587	4,153
Minority interest	88	0	0	0	0
Income from JV/Associates	1	(1)	(2)	(8)	(8)
Reported PAT	9,646	478	3,189	10,657	12,640
PAT growth (%)	20.6	(95.0)	567.3	234.2	18.6
Adjusted PAT	11,016	5,811	4,430	10,657	12,640
Diluted EPS (Rs)	10.0	0.5	3.3	11.1	13.2
Diluted EPS growth (%)	20.6	(95.0)	567.3	234.2	0.0
DPS (Rs)	2.5	0.0	1.0	3.3	3.9
Dividend payout (%)	24.9	0.0	30.0	30.0	30.0
EBITDA margin (%)	21.0	13.6	11.4	20.1	21.4
EBIT margin (%)	18.0	9.7	7.1	15.8	17.2
Effective tax rate (%)	29.6	27.2	24.8	25.2	24.7
NOPLAT (pre-IndAS)	10,390	5,743	4,634	10,516	12,437
Shares outstanding (mn)	960.3	960.3	960.3	960.3	960.3

Source: Company, Emkay Research

Cash flows					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
PBT	15,524	7,979	5,892	14,253	16,801
Others (non-cash items)	0	0	0	0	0
Taxes paid	(4,597)	(2,167)	(1,460)	(3,587)	(4,153)
Change in NWC	(9,849)	(3,436)	(10,306)	(5,481)	(8,369)
Operating cash flow	1,669	1,741	(3,432)	9,017	8,331
Capital expenditure	(2,915)	(3,793)	(2,800)	(2,500)	(2,500)
Acquisition of business	0	0	0	0	0
Interest & dividend income	270	270	270	270	270
Investing cash flow	5,630	(2,675)	(2,200)	(1,660)	(1,540)
Equity raised/(repaid)	0	0	0	0	0
Debt raised/(repaid)	(3,468)	2,057	55	0	0
Payment of lease liabilities	353	2,033	55	0	0
Interest paid	(451)	(702)	(868)	(640)	(680)
Dividend paid (incl tax)	(2,401)	0	(957)	(3,197)	(3,792)
Others	11,751	5,526	9,007	0	0
Financing cash flow	5,431	6,881	7,237	(3,837)	(4,472)
Net chg in Cash	12,731	5,948	1,605	3,520	2,319
OCF	1,669	1,741	(3,432)	9,017	8,331
Adj. OCF (w/o NWC chg.)	(8,180)	(1,695)	(13,738)	3,535	(38)
FCFF	(1,246)	(2,052)	(6,232)	6,517	5,831
FCFE	(1,427)	(2,484)	(6,831)	6,147	5,420
OCF/EBITDA (%)	9.7	15.8	(34.9)	50.4	40.5
FCFE/PAT (%)	(14.8)	(519.8)	(214.2)	57.7	42.9
FCFF/NOPLAT (%)	(12.0)	(35.7)	(134.5)	62.0	46.9

Source: Company, Emkay Research

Balance Sheet					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	961	961	961	961	961
Reserves & Surplus	107,665	104,222	108,268	115,728	124,576
Net worth	108,626	105,183	109,229	116,689	125,537
Minority interests	0	0	0	0	0
Deferred tax liability (net)	(3,080)	(4,229)	(4,229)	(4,229)	(4,229)
Total debt	763	2,820	2,875	2,875	2,875
Total liabilities & equity	106,309	103,773	107,875	115,335	124,183
Net tangible fixed assets	6,073	7,455	7,770	7,764	5,968
Net intangible assets	5,343	4,645	3,376	2,031	582
Net ROU assets	835	1,497	1,566	1,576	3,262
Capital WIP	872	191	191	191	191
Goodwill	0	0	0	0	0
Investments [JV/Associates]	0	0	0	0	0
Cash & equivalents	13,382	6,278	2,603	5,923	7,962
Current assets (ex-cash)	102,781	109,230	119,741	125,038	137,991
Current Liab. & Prov.	23,005	27,167	27,373	27,188	31,772
NWC (ex-cash)	79,776	82,062	92,368	97,850	106,219
Total assets	106,309	103,773	107,875	115,335	124,183
Net debt	(12,619)	(3,457)	272	(3,048)	(5,086)
Capital employed	106,281	102,128	107,875	115,335	124,183
Invested capital	92,027	95,660	105,081	109,221	116,030
BVPS (Rs)	113.1	107.8	113.7	121.5	130.7
Net Debt/Equity (x)	(0.1)	0.0	0.0	0.0	0.0
Net Debt/EBITDA (x)	(0.7)	(0.3)	0.0	(0.2)	(0.2)
Interest coverage (x)	0.0	0.1	0.1	0.0	0.0
RoCE (%)	15.4	8.3	6.4	13.3	14.6

Source: Company, Emkay Research

Valuations and key Ratios					
Y/E Mar	FY22	FY23	FY24E	FY25E	FY26E
P/E (x)	20.5	38.8	50.9	21.2	17.9
P/CE(x)	16.5	24.8	27.3	15.3	13.3
P/B (x)	2.1	2.2	2.1	1.9	1.8
EV/Sales (x)	2.6	2.7	2.6	2.5	2.3
EV/EBITDA (x)	12.4	20.2	22.9	12.4	10.7
EV/EBIT(x)	14.2	27.7	36.1	15.6	13.1
EV/IC (x)	2.3	2.3	2.1	2.0	1.9
FCFF yield (%)	(0.6)	(0.9)	(2.8)	3.0	2.7
FCFE yield (%)	(0.6)	(1.1)	(3.1)	2.8	2.4
Dividend yield (%)	1.1	0.0	0.4	1.4	1.7
DuPont-RoE split					
Net profit margin (%)	13.5	7.2	5.1	12.0	13.1
Total asset turnover (x)	0.8	0.8	0.8	0.8	0.8
Assets/Equity (x)	1.0	1.0	1.0	1.0	1.0
RoE (%)	10.6	5.5	4.2	9.4	10.4
DuPont-RoIC					
NOPLAT margin (%)	12.7	7.1	5.3	11.8	12.9
IC turnover (x)	0.9	0.9	0.9	0.8	0.9
RoIC (%)	12.0	6.1	4.6	9.8	11.0
Operating metrics					
Core NWC days	355.6	370.3	389.2	400.7	402.5
Total NWC days	355.6	370.3	389.2	400.7	402.5
Fixed asset turnover	3.1	2.8	2.7	2.5	2.6
Opex-to-revenue (%)	29.6	31.1	32.1	30.9	30.6

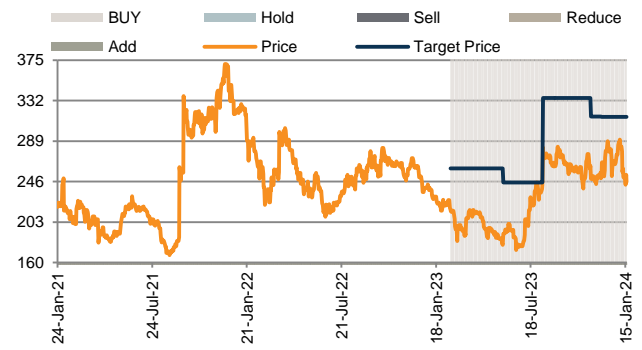
Source: Company, Emkay Research

RECOMMENDATION HISTORY - DETAILS

Date	Closing Price (INR)	TP (INR)	Rating	Analyst
08-Jan-24	278	315	Buy	Pulkit Chawla
30-Nov-23	253	315	Buy	Pulkit Chawla
10-Nov-23	249	315	Buy	Pulkit Chawla
02-Nov-23	269	335	Buy	Pulkit Chawla
10-Aug-23	282	335	Buy	Pulkit Chawla
10-Aug-23	282	265	Buy	Pulkit Chawla
26-May-23	191	245	Buy	Pulkit Chawla
14-Feb-23	216	260	Buy	Pulkit Chawla

Source: Company, Emkay Research

RECOMMENDATION HISTORY - TREND



Source: Company, Bloomberg, Emkay Research

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