

Zee Entertainment Enterprises Ltd.

1st February 2024

Sony calls off merger with ZEEL

How it all started?

On 21st December 2021, Zee Entertainment Enterprises Ltd. (ZEEL) entered into a merger cooperation agreement with Culver Max Entertainment Pvt. (CMEPL), whose operating name is Sony Pictures India Ltd. and Bangla Entertainment Pvt. Ltd. (BEPL). The scheme of arrangement was approved by the NCLT, Mumbai bench, on 11th August 2023.

ZEEL exercised the right to enter negotiations

As per the terms of the agreement, ZEEL, on 17th December 2023, announced that it has exercised its right to require CMEPL and BEPL to enter negotiations for a period of 30 days to arrive at a mutual agreement of the end date for completion of the transaction as per the terms of MCA.

Termination of the merger

During the 30-day period to conduct good-faith negotiations, interested parties failed to arrive at a consensus. The clarifications issued by the Company mention that Mr. Punit Goenka, MD & CEO of ZEEL, was ready to step down in the interest of the merger and that ZEEL proposed an extension of a maximum of six months for the consummation of the transaction. However, CMEPL did not provide any counter-proposal for an extension but rather chose to terminate the merger.

Other demands of CMEPL

Apart from terminating the merger cooperation agreement, CMEPL and BEPL have put forth a demand seeking termination fees of \$90 Mn on account of alleged breaches of the terms of MCA by ZEEL. The Company denies all the assertions raised by CMEPL and BEPL on the alleged breaches under the terms of MCA, including their claims for the termination fee.

ZEEL's reply to CMEPL and BEPL

On 24th January 2023, ZEEL informed stock exchanges that they had issued a reply to CMEPL and BEPL and disclosed important contents of the same. In its reply, ZEEL has denied any breach of obligations under the terms laid out by the MCA. In addition to this, the Company also informed counterparties that their claim for termination fee is legally untenable and baseless.

Counterparties were also communicated that it's them who have defaulted on their obligations to give effect to the scheme of merger sanctioned by the NCLT. Over and above this, ZEEL asked CMEPL and BEPL to immediately withdraw the termination and confirm that they will perform their obligations to implement the merger scheme sanctioned by the NCLT.

The filing also mentioned that ZEEL had approached the NCLT, Mumbai bench seeking directions to implement the merger scheme and has also initiated appropriate legal action to contest the claims made by CMEPL and BEPL in the arbitration proceedings before the Singapore International Arbitration Center (SIAC).

Merger termination will leave ZEEL financially weak

The merger between ZEEL and CMEPL would have created a mega entertainment entity with ~70-75 channels.

NEUTRAL

CMP Rs. 170

TARGET Rs. 174 (+2.4%)

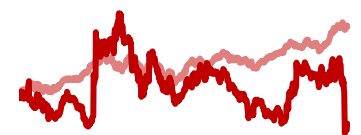
Company Data

Bloomberg Code	Z IN
MCAP (Rs. Mn)	1,63,370
O/S Shares (Mn)	961
52w High/Low	300 / 153
Face Value (in Rs.)	1
Liquidity (3M) (Rs. Mn)	6,911

Shareholding Pattern %

	Dec-23	Sep-23	Jun-23
Promoters	3.99	3.99	3.99
FII's	28.19	35.00	33.40
DII's	43.57	42.22	40.77
Non-Institutional	24.25	18.79	21.85

ZEEL vs Nifty



	Jan, 21	Jan, 22	Jan, 23	Jan, 24
ZEEL				
NIFTY				

Source: Keynote Capitals Ltd.

Key Financial Data

(Rs Bn)	FY23	FY24E	FY25E
Revenue	80.8	90.3	98.8
EBITDA	11.1	12.0	18.6
Net Profit	0.5	2.7	9.8
Total Assets	137.3	141.3	150.8
ROCE (%)	4%	7%	9%
ROE (%)	0%	2%	9%

Source: Company, Keynote Capitals Ltd.

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ZEEL | Company Update

Apart from this, Sony was also going to infuse ~\$1.5 Bn in the merged entity, which could have been utilized behind content acquisition/development to combat competition.

Now that the merger has been called off, the expected improvement in the Company's financial position due to ~\$1.5 Bn cash infusion by CMEPL will not take place. This leaves ZEEL only with ~Rs. 5.7 Bn worth of cash and bank as of Q2 FY24, along with its cash generation ability of Rs. 7-8 Bn per annum to invest in acquiring/developing new content. In addition to this, ZEEL will now have to fight all pending litigations on its own, including an added litigation against CMEPL and BEPL.

Can ZEEL survive on its own?

Though ZEEL may not struggle for its survival, the Company's current financial position indicates that it will find it difficult to simultaneously manage litigations, new content acquisition/development and fighting OTT giants like Amazon, Jio Cinema, Netflix, etc. In addition to this, apprehensions about low promoter holding and weak corporate governance will again erupt strongly as the perception around improvement in governance with CMEPL owning the majority stake in the merger entity will not hold true anymore.

Avenues available with ZEEL

Currently, ZEEL has two choices: a) continue to operate on its own and b) explore a merger with a peer. No matter what choice the Company takes, the following two things will continue to challenge the smooth progress and valuation rating of ZEEL.

1. Mr. Punit Goenka being part of the active management/Board.
2. Ongoing litigations with multiple parties, including CMEPL and BEPL.

View & Valuation

Owing to multiple reasons, including weak financial positioning, weak corporate governance in the absence of CMEPL's involvement and the steep price fall post the merger-cancellation news, we downgrade ZEEL from BUY to a NEUTRAL rating with a target price of Rs. 174 (17x FY25E EPS i.e., 30% discount to 5-year median PE). Our estimates indicate that due to the merger being called off, the exceptional expense that was significantly impacting ZEEL's PAT will go down to NIL, resulting in a significant improvement in PAT. However, we continue to closely monitor development around litigations and will revisit our estimates in case of significantly negative developments.

Financial Statement Analysis

Income Statement

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Net Sales	81,857	80,879	90,342	98,780	1,09,466
Growth %		-1%	12%	9%	11%
Operational Expenses	40,418	44,686	49,688	49,390	54,733
Employee Expenses	8,261	8,238	9,202	10,061	10,947
Other Expenses	15,413	16,886	19,424	20,744	21,893
EBITDA	17,766	11,069	12,029	18,585	21,893
Growth %		-38%	9%	55%	18%
Margin%	22%	14%	13%	19%	20%
Depreciation	2,213	3,128	3,561	3,877	4,194
EBIT	15,554	7,941	8,467	14,708	17,699
Growth %		-49%	7%	74%	20%
Margin%	19%	10%	9%	15%	16%
Interest Paid	438	702	846	705	705
Other Income & exceptional	-132	-2,558	-2,000	800	800
PBT	14,984	4,681	5,621	14,803	17,794
Tax	4,448	2,167	1,686	5,033	6,050
PAT	10,537	2,514	3,935	9,770	11,744
Others (Minorities, Associates)	1	-1	-1	-1	-1
Loss from Discontinued Operations	-980	-2,036	-1,219	0	0
Net Profit	9,558	477	2,715	9,769	11,743
Growth %		-95%	469%	260%	20%
Shares (Mn)	960.5	960.5	960.5	960.5	960.5
EPS	10.04	0.50	2.83	10.17	12.23

Balance Sheet

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Cash, Cash equivalents & Bank	12,733	8,040	4,456	9,711	11,588
Current Investments	242	0	0	0	0
Debtors	17,375	16,088	18,068	18,768	20,799
Inventory	63,862	73,079	79,501	83,963	93,046
Short Term Loans & Advances	0	0	0	0	0
Other Current Assets	17,261	15,066	15,066	15,066	15,066
Total Current Assets	1,11,473	1,12,273	1,17,091	1,27,509	1,40,499
Net Block & CWIP	11,235	13,307	12,456	11,542	10,085
Long Term Investments	1,472	830	829	828	827
Other Non-current Assets	8,216	10,873	10,873	10,873	10,873
Total Assets	1,32,396	1,37,284	1,41,249	1,50,752	1,62,283
Creditors	13,719	17,494	18,068	19,756	21,893
Provision	119	135	135	135	135
Short Term Borrowings	14	19	19	19	19
Other Current Liabilities	8,321	8,888	8,888	8,888	8,888
Total Current Liabilities	22,172	26,536	27,110	28,798	30,935
Long Term Debt	21	40	40	40	40
Deferred Tax Liabilities	0	0	0	0	0
Other Long Term Liabilities	1,575	3,489	3,489	3,489	3,489
Total Non Current Liabilities	1,596	3,529	3,529	3,529	3,529
Paid-up Capital	961	961	961	961	961
Reserves & Surplus	1,07,667	1,06,258	1,09,649	1,17,464	1,26,858
Shareholders' Equity	1,08,628	1,07,219	1,10,610	1,18,425	1,27,819
Non Controlling Interest	0	0	0	0	0
Total Equity & Liabilities	1,32,396	1,37,284	1,41,249	1,50,752	1,62,283

Cash Flow

Y/E Mar, Rs. Mn	FY22	FY23	FY24E	FY25E	FY26E
Pre-tax profit	14,984	4,681	5,621	14,803	17,794
Discontinued Operations	-830	-2,069	0	0	0
Adjustments	2,419	5,294	3,607	3,782	4,099
Change in Working Capital	-9,638	-2,722	-7,828	-3,474	-8,976
Total Tax Paid	-4,965	-3,893	-1,686	-5,033	-6,050
Cash flow from operating Activities	2,800	1,291	-286	10,078	6,867
Net Capital Expenditure	-2,286	-2,412	-2,710	-2,963	-2,737
Change in investments	7,840	-7	0	0	0
Other investing activities	217	403	0	0	0
Cash flow from investing activities	5,771	-2,016	-2,710	-2,963	-2,737
Equity raised / (repaid)	-4,034	0	0	0	0
Debt raised / (repaid)	9	24	0	0	0
Dividend (incl. tax)	-2,850	-2,882	-543	-1,954	-2,349
Other financing activities	-279	-1,224	-846	-705	-705
Cash flow from financing activities	-7,154	-4,082	-1,389	-2,659	-3,054
Net Change in cash	1,417	-4,807	-4,385	4,456	1,077

Valuation Ratios

	FY22	FY23	FY24E	FY25E	FY26E
Per Share Data					
EPS	10	0	3	10	12
Growth %		-95%	469%	260%	20%
Book Value Per Share	113	112	115	123	133
Return Ratios					
Return on Assets (%)	8%	0%	2%	7%	8%
Return on Equity (%)	9%	0%	2%	9%	10%
Return on Capital Employed (%)	9%	4%	7%	9%	10%
Turnover Ratios					
Asset Turnover (x)	0.6	0.6	0.6	0.7	0.7
Sales / Gross Block (x)	3.2	2.9	2.8	2.8	2.9
Working Capital / Sales (x)	104%	108%	97%	96%	95%
Receivable Days	82	76	69	68	66
Inventory Days	532	559	560	604	590
Liquidity Ratios					
Current Ratio (x)	5.0	4.2	4.3	4.4	4.5
Interest Coverage Ratio (x)	36.4	12.4	11.0	22.0	26.2
Total Debt to Equity	0.0	0.0	0.0	0.0	0.0
Net Debt to Equity	-0.1	-0.1	0.0	-0.1	-0.1
Valuation					
PE (x)	28.7	427.0	84.3	23.4	19.5
Earnings Yield (%)	3%	0%	1%	4%	5%
Price to Sales (x)	3.4	2.5	2.5	2.3	2.1
Price to Book (x)	2.5	1.9	2.1	1.9	1.8
EV/EBITDA (x)	14.9	18.4	18.0	11.6	9.9
EV/Sales (x)	3.2	2.5	2.4	2.2	2.0

Source: Company, Keynote Capitals Ltd. estimates

KEYNOTE Rating History

Date	Rating	Market Price at Recommendation	Upside/Downside
3 rd February 2023	BUY	221	+14%
14 th February 2023	BUY	216	+17%
29 th May 2023	BUY	193	+25%
11 th August 2023	BUY	271	+17%
13 th November 2023	BUY	252	+15%
1 st February 2024	NEUTRAL	170	+2%

Rating Methodology

Rating	Criteria
BUY	Expected positive return of > 10% over 1-year horizon
NEUTRAL	Expected positive return of > 0% to < 10% over 1-year horizon
REDUCE	Expected return of < 0% to -10% over 1-year horizon
SELL	Expected to fall by >10% over 1-year horizon
NOT RATED (NR)/UNDER REVIEW (UR)/COVERAGE SUSPENDED (CS)	Not covered by Keynote Capitals Ltd/Rating & Fair value under Review/Keynote Capitals Ltd has suspended coverage

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