

Initiating Coverage

SAREGAMA (GRACOM)**On Song...**

- **Changing business model**

Saregama is set to script a turnaround piggybacking on the emergence of new entertainment media such as FM Radio, mobile music and digitalized music on internet. The company has built a moat around its huge music business by diversifying into digital music, internet radio and online music sales.

- **Financials back on track**

Piracy at the turn of the century killed the world music industry worldwide and Saregama was no exception. However, since FY2005 the company has turned the corner with a new management and more focus on new income streams such as FM, mobile ring tones etc.

- **Film foray to be key contributor**

We expect the film and home video division to contribute handsomely with key tie-ups with big international studios in place. Re-entry into the film distribution and production space and 14 hours/week of TV content production will diversify the business and drive growth from non-music segment

- **New portal – the next big catalyst**

With key features such songs, video & entertainment downloads etc and strong macro undercurrents of online music sales we believe that Saregama has winner in its new portal saregama.com. We believe this to be its valuation catalyst with newer e-commerce portals such Naukri being valued upwards of Rs 2000 crore.

Valuations

We expect Saregama to once again dominate the Indian music industry and replicate its dominant performance which it showed for decades. Given the robust growth in the high margin business like publishing and home video coupled with effectively utilization of the music library we expect Saregama to command improved valuations given its high earnings visibility. At the current price of Rs 302, the stock at a P/E of 21.15x FY08E EPS of Rs14.28 and 16.77x FY09E EPS of Rs 18.01. We rate the stock as an OUTPERFORMER with a price target of Rs 405, 22.5x FY09E.

Exhibit 1: Key Financials

Year to March 31	FY09E	FY08E	FY07	FY06
Net Profit	26.42	20.95	13.01	6.11
Shares in issue (crore)	1.47	1.47	1.47	1.47
EPS (Rs)	18.01	14.28	8.87	4.16
% Growth	26.1%	61.0%	112.9%	
P/E (x)	16.77	21.15	34.05	72.51
Price/Book (x)	3.25	4.03	4.64	5.37
EV/EBIDTA	9.34	16.06	30.35	50.27
RoNW (%)	19.38%	19.06%	13.64%	7.41%
RoCE (%)	27.08%	21.11%	15.31%	9.08%

Source: ICICIdirect Research

Potential Upside 34%

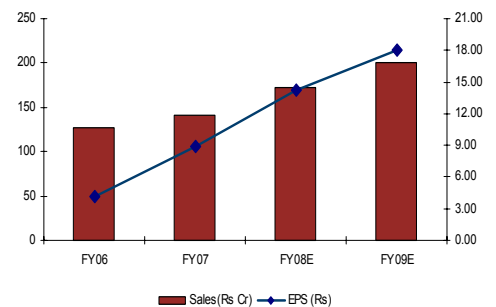
Current price **Rs 302** → Target price **Rs 405**

Time frame 12 months

OUTPERFORMER

Ankit Kedia

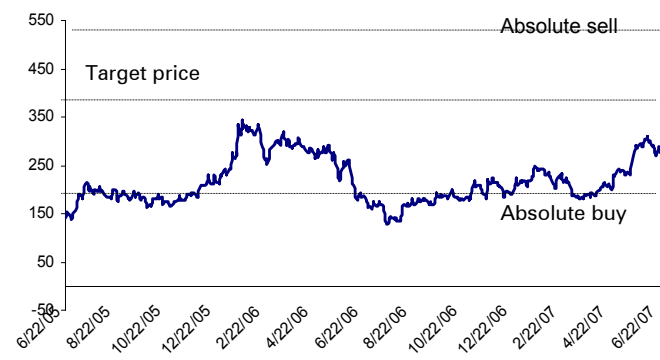
ankit.kedia@icicidirect.com

Sales & EPS trend**Stock metrics**

Promoters holding	50.76%
Market Cap	Rs440 crore
52 Week H/L	319 / 122
Sensex	14,499
Average volume	11,451

Comparative return metrics

Stock return	3 M	6M	12M
UTV Software	89%	121%	250%
Entertainment Network	24%	55%	84%
Zee Entertainment	25%	8%	30%
Saregama	54%	52%	56%



Company Background

Saregama India Ltd, formerly known as the Gramophone Company of India, is India largest and most popular music recording company. The company has a music library of more than 3 lakh songs and covers more than 50% of the songs recorded in the country. The company also has relationships with top international studios along with having global footprints. Saregama has four subsidiaries Saregama PPLC, RPG Global Music for distribution and licensing in Europe, USA, South Africa, East Asia, Dubai and Mauritius. Saregama Films Ltd produces and distributes films and TV content while Kolkata Metro houses the internet portal.

Saregama over the years has expanded its business from audio to home video, publishing, digital, events, films production and distribution and audio visuals.

Share holding pattern

Shareholder	Percentage holding (%)
Promoters	50.76
Institutional investors	19.36
Other investors	13.78
General public	16.1

Promoter & Institutional holding trend

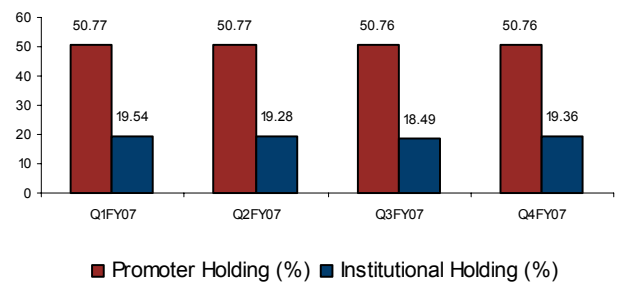
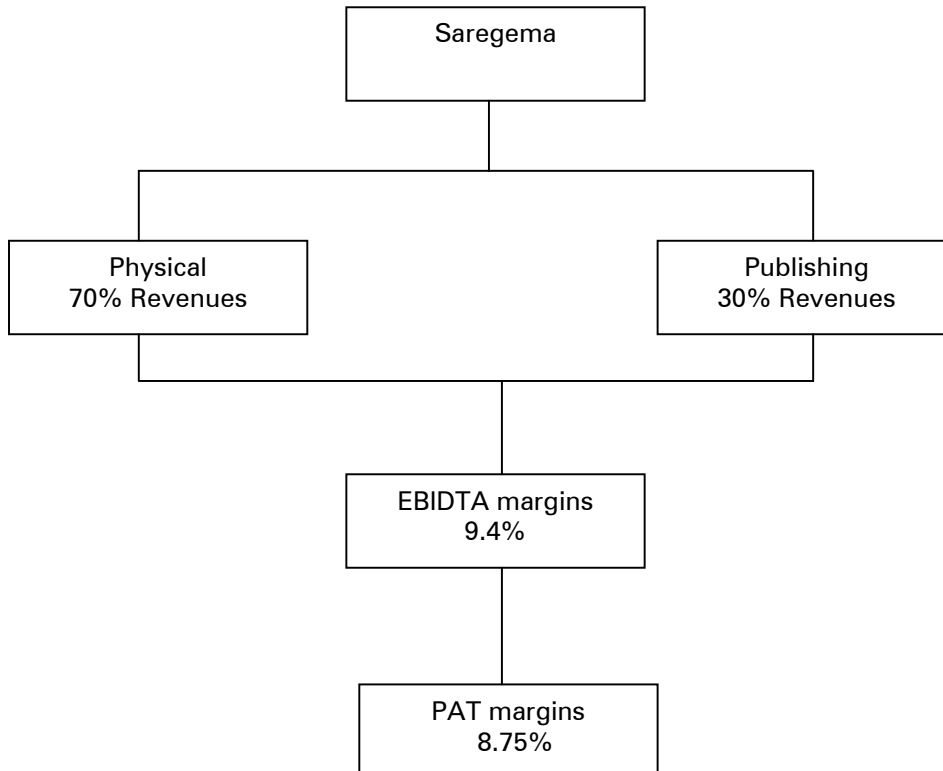


Exhibit 2: Business Flow chart



Source: ICICIdirect Research

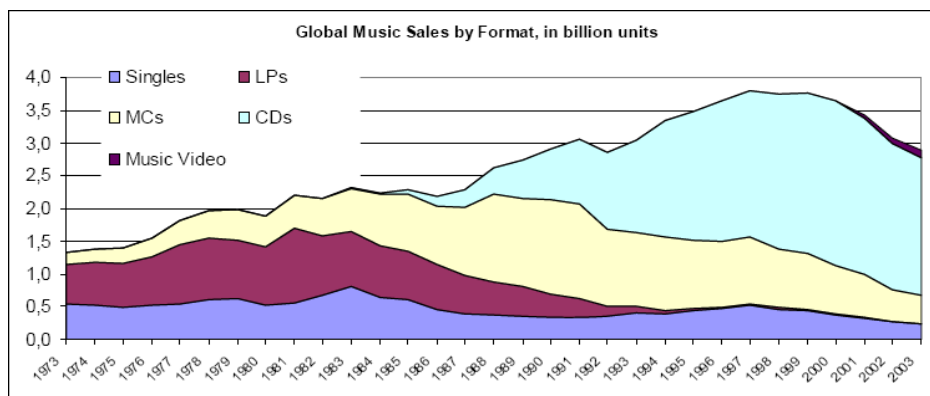
Investment Rationale

Changing Business Model

Saregama dominated the music industry for decades till late 20th century having more than 3 lakh music tracks, 25,000 signed artists, 47,000 copyrights under its banner and owning half of the Indian music space. The company not only dominated the Hindi music space but also regional music markets across all genres. However, on turn of the century with piracy catching up in all formats and with severe competition coupled with high music acquisition rights and declining sales and realizations, Saregama turned into red in 2002 for the first time.

Saregama has more than 3 lakh music tracks i.e more than half of the Indian music space

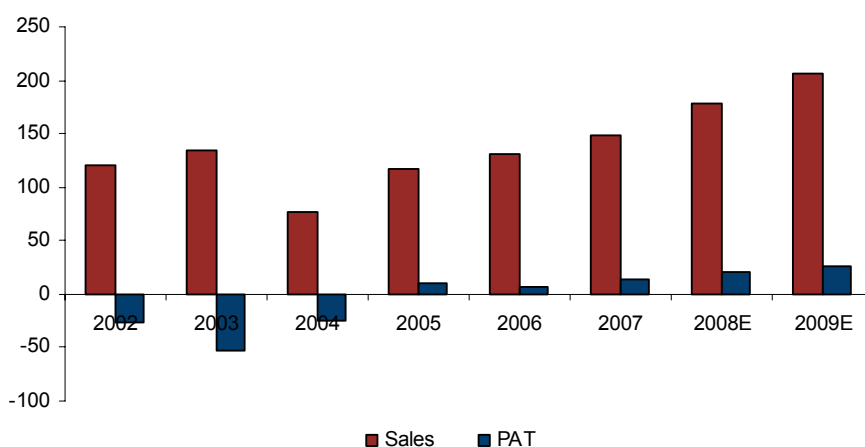
Exhibit 3: Declining Global Music Sales



Source: Industry

Declining sales affected all global music companies

Exhibit 4: Changing times for Saregama

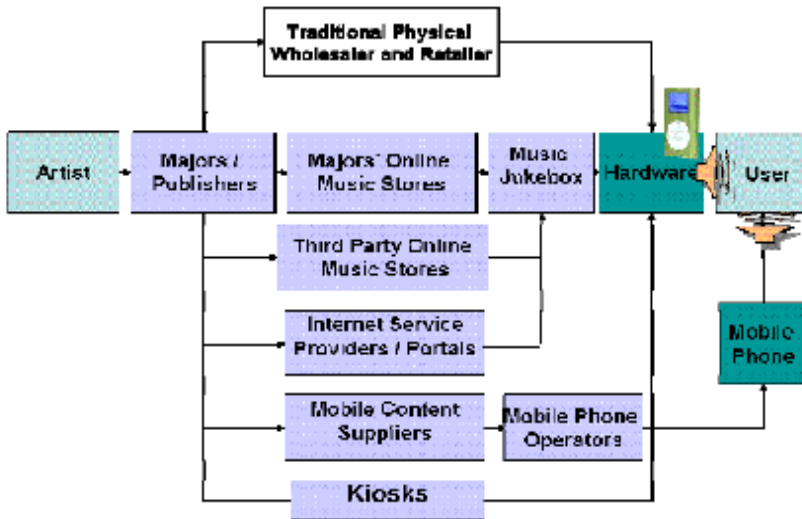


Changing times for Saregama from losses in 2002-04 to turning around in 2005

Source: ICICIdirect Research

However since 2005 the company once again crawled to profitability with a changing business model capturing newer and profitable ways to monetize the existing catalogue on digital platforms such as radio, mobile and internet.

Exhibit 5: Changing Business Model



Changing business model to spurt growth and increase margins

Source: ICICIdirect Research

Radio to bring good business

We see the current spurt of radio stations as a boon to music companies including Saregama. Every radio station has to pay royalties to the music industry for the music they play per needle hour basis. Under the recent phase II policy for FM radio, 266 licenses were sold and further de-regulation is expected in the Phase III taking the total FM licenses to more than 500. Saregama has more than 33% share of the catalogue music played on the FM stations and 15% share of the new music played. We believe this will bring in significant revenues to the company in the coming years. In FY07 radio contributed Rs 6.9 crore to the topline and is expected to contribute around Rs 16.88 crore by FY09.

Rs 160 crore opportunity with more than 266 new FM stations coming within 1 year for music industry

Exhibit 6: Allotted FM stations under Phase II

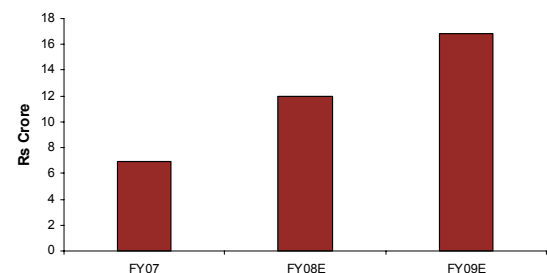
Class	Population	Cities	No. of Stations
A+	Metros	4	32
A	> 2mn	9	39
B	> 1mn	17	55
C	> 0.3mn	47	119
D	> 0.1mn	10	21
Total		87	266

Source: Industry, ICICIdirect Research

Convergence with telecom to provide regular cash flows

Music industry is expected to be the biggest beneficiary of the convergence of media with telecommunication as it is expected to contribute more than 35% of the value added services. Indian telecom market has seen an exponential growth in the last few years and we expect the mobile subscribers to increase from current 170 million to 410 million by 2010. 10% of the average revenue per user (ARPU) comes from value added services of which 35-40% is non SMS and from ring tones, images, videos, full track downloads etc. On an average the companies have more than 70,000-80,000 download per day.

Revenues from radio business



Source: ICICIdirect Research

Win-win situation for both, the content provider and the telecom operator

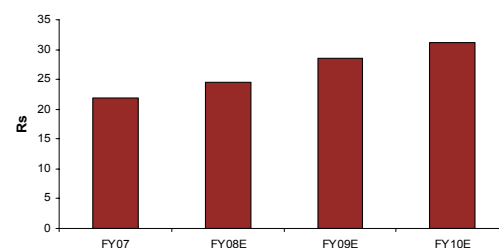
Telecom operators are also marketing these services to subscribers as they have higher margins for the operators as they get to retain a higher share compared to the content provider.

Saregama has tied up with handset manufactures such as Motorola, Nokia for pre loaded content on their phones and is in talk with other manufactures as well. The company has also signed deals with operators for mobile downloads through their networks. Saregama has also started selling Value Added Services (VAS) cards directly to the subscribers where in the customer can download three tones in Rs 25 card. We believe the time is right for Saregama to capitalize on the telecom boom and effectively cash on the 3 lakh songs which have a high repeat value with the Indian audience providing regular cash flows.

▪ **Internet-biggest growth opportunity**

We believe internet is the biggest growth opportunity for any music company to fully exploit the music rights and hence since last couple of years we have seen opening of more than 500 legitimate online music site in over 40 countries with the global digital market growing as shown. Currently Saregama offers its music library to multiple websites such as MSN music, Sony Connect and hosts of other sites in different countries for India focused music downloads through its offices in UK, USA, Dubai and other places in the world.

VAS Revenues/Subscriber/Month



Source: ICICIdirect Research

Exhibit 7: Global Digital Music Market

In Million	2005	2006	Change
Broadband Lines	209	280	34%
Song Catalogue online	2	4	100%
Single tracks download	420	795	89%
Subscription service users	2.8	3.5	25%
Mobile subscription	1817	2017	11%
3G mobile subscription	90	137	52%
Portable player sales	84	120	43%

Source: IFPI, PWC, M: Metrics, Understanding & Solutions

▪ **New Portal – next big catalyst**

To capture this global digital Indian music demand the company is planning to launch its own website similar to the iTunes model and is expected to offer hosts of services as shown in exhibit8. Users will be able to download more than 27,000 hours of music at Rs 12 per song while other services are expected to be priced between Rs 5-100. Subscription services for users are also expected for hosts of products which will have the customer come back to the portal regularly. We believe such a business model to deliver in long run.

Internet: The best way to fully exploit music rights

Increasing music downloads from internet sites with growing broadband penetration and portable player sales

Exhibit 8: Digital Content Sales

Audio Entertainment Content	Audio-Video Entertainment Content	Video Entertainment Content
Full Songs - Download, Tethered Downloads	Video Downloads	Web magazines
Ringtones, Ring back tones, Master tones	Video Tones	Wallpapers, Screensavers, Themes
Internet Radio	Mobisodes Interactive Content	E-Cards
Live Events	Podcasts	Web Casts

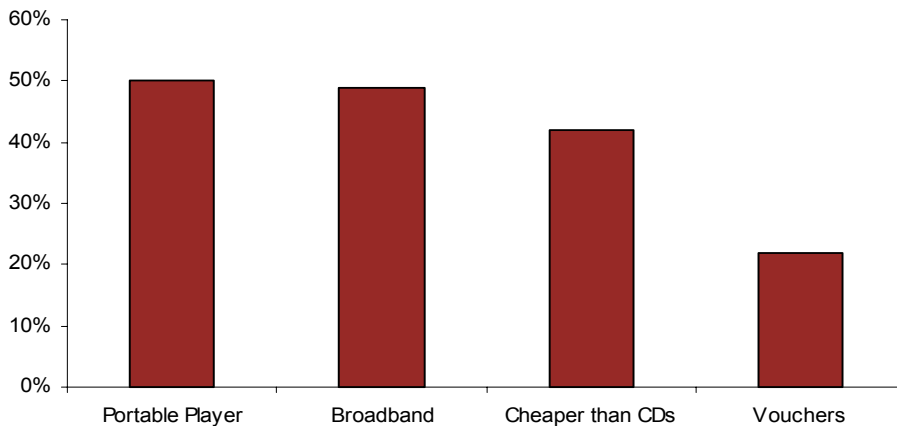
Source: Company, ICICIdirect Research

Hosts of services to be offered by Saregama on its website

We believe the major drivers for online music buying is easy accessibility to portable music player coupled with high broadband penetration and cheap music. The India markets are mature enough for this and Saregama will place to capture this online music space. The company also has expertise in the online space with its website hamaraCD.com where a person can create one's own CD of favorite songs. We believe the management will leverage its expertise from this into the new portal.

HamaraCD.com to a unique proposition to create one's own music CD

Exhibit 9: Drivers to online music buying



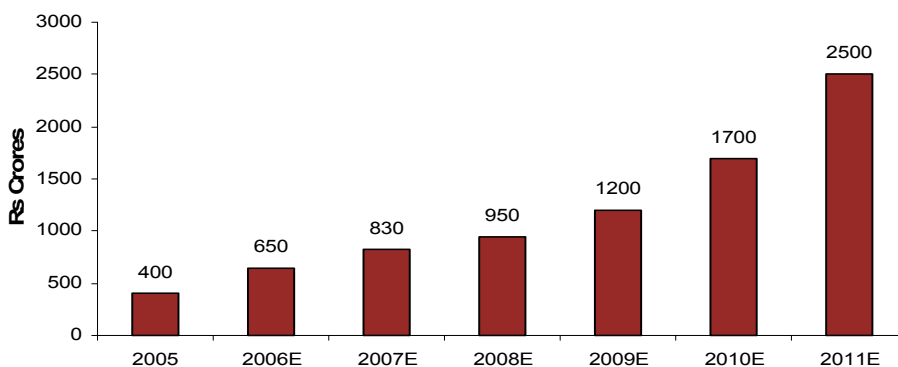
Source: IFPI/M-Lab, Nov-06 Survey, Base: All who buy online music

Home Video market to explode

Home video market is expected to grow fourfold to Rs 2500 crore by 2011E and comprise around 20% of the film industry revenues as shown in Exhibit: 10 with more than 3 million Indian households having DVD players. Saregama generates around 18% of the revenues from this segment and has tied up with the biggest five international studios houses of Warner Brothers, Universal, Paramount, MGM, Miramax and BBC for distribution of English home video in India. Saregama is expanding this business by mapping more than 8000 video libraries across the country and by having dubs of the popular movies in most regional languages. The company is also creating innovative schemes along with deals with retail store to create special DVD zones. The company has also started to distribute Hindi movies DVDs and VCDs such as *Bluffmaster*, *Taxi No 9211*, *Woh Lamhe*, *Aawarapan* etc which we believe will help the company to gain market share. This being a high margin business we expect this vertical to contribute significantly to the bottomline and holds the potential to be a blockbuster for the company.

Exclusive tie-up with top 5 international studio houses for distribution of English home videos in India

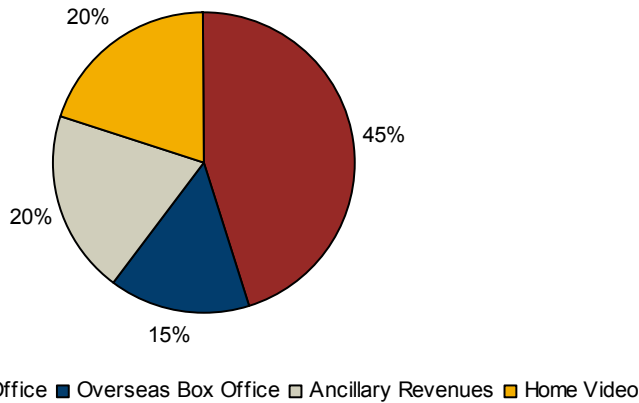
Exhibit 10: Home Video Market



Rs 2500 crore opportunity by 2011 & with more than 30% margins in home video to drive growth

Source: FICCI Report

Exhibit 11: Film industry revenue break up



Increasing home video share in the film industry revenues

Source: ICICIdirect Research

Diversification into film production and TV content

Saregama has once again decided to foray into the movie production space with a small budget of Rs 8 crores every year through its 100% subsidiary Saregama Films. The company has signed renowned filmmakers such as Aparna Sen and Ken Ghosh for its movies. The company is set to release its first Indo-US English movie titled *Karma Confession & Holi* by December 07 while its Hindi movie *Chain Kuli Ki Main Kuli* directed by Ken Ghosh and starring Rahul Bose is releasing in July07. *Japanese Wife* a Bengali film by Aparna Sen will release early 2008. We expect this business to act as a content provider for other verticals such as audio music sales and home video distribution.

Ken Ghosh and Aparna Sen to drive film production

Since last one year the company has also infused capital in TV content programming wherein they produce 14 hours of programming content for Sun TV in four southern languages and expect this to increase to 20 hours by year end. The company is also expecting to diversify into newer genres and languages by entering the national channels. These businesses will give the company diversification into other media business and de-risk its businesses.

14 hours of TV content to increase to 20 hours by year end

Key Concerns

Declining Market Share

Saregama now has only 15% share of new hit tracks while before the company had more than 35% share in the same. We believe an inability to acquire more rights could dampen publishing revenues in some years. However, we believe regular cash flows from the digital income will provide enough cash to acquire more rights in coming years.

Competition from corporate houses

We have seen a trend where more and more corporate houses are starting their own music publishing companies to market the music of their produced movies. Houses such as Yash Raj Films, Mukta Arts producing blockbuster movies have done the same and we expect other to follow soon. This could impact Saregama's market share for hit music further.

Financials

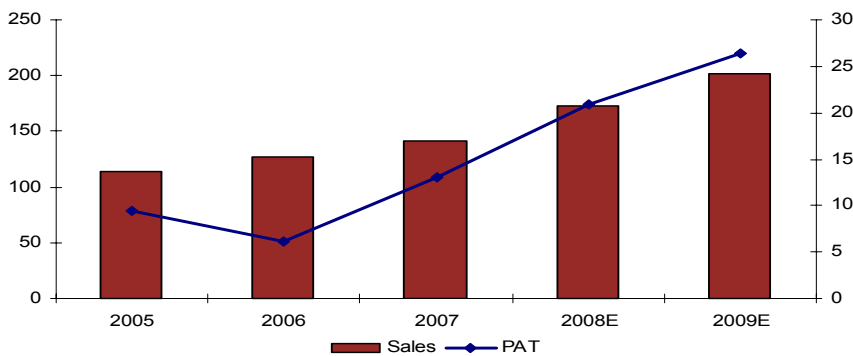
Moving towards profitable growth path

Saregama is likely to script a sustainable growth story over next two years on back of growing demand for digital music and expected surge in home video coupled with subdued physical sales. We believe Saregama would register strong growth in revenues due to high operating leverage.

Revenues for the publishing is expected to grow from Rs 17.26 crore in FY06 to Rs 70.65 crore in FY09 (CAGR of 60%). As revenues in publishing are directly related to the number of hits songs in the catalogue and the easy accessibility to the customer and as Saregama having more than 3 lacs tracks coupled with multiple revenue streams to monetize them, we expect Saregama to be the prime beneficiary of the digital revolution. Revenues from physical sales are expected to grow at a flat rate of 3.7% from FY06-09. However we expect the PAT to grow at a faster rate of 62.9% CAGR from Rs 6.11 crore in FY06 to Rs 26.42 crore in FY09.

Revenues to grow at a CAGR of 16.6% while PAT to grow at 62.9% from FY06-09

Exhibit 12: Revenue & Profitability Growth

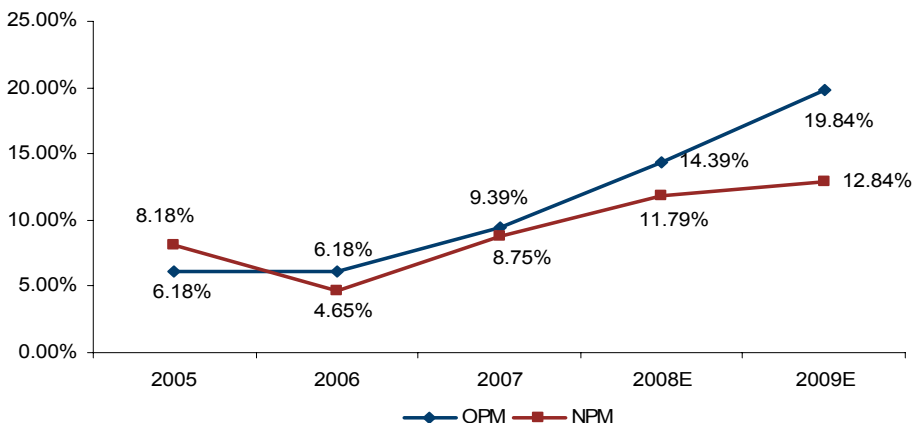


Source: ICICIdirect Research

Steady margin expansion

Margins from radio, mobile and internet business are high compared to that of physical sales. Thus there is significant scope for margin expansion depending on the company's ability to grow its revenue streams. We expect operating margin for Saregama to expand steadily to 19.84% by FY09E and net profit margins to be at 12.84% by FY09E on consolidated basis. The company would also have strong RoCE and RoNW of 27.08% and 19.38% respectively.

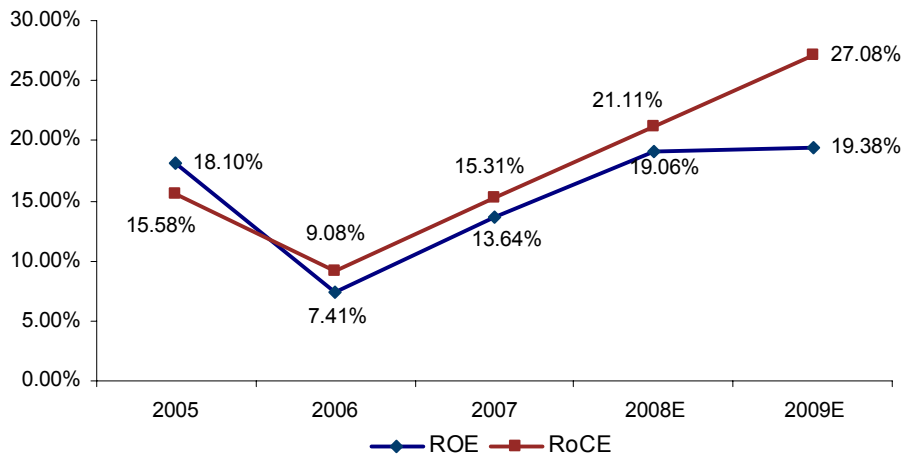
Exhibit 13: Margin Expansion



Margins to expand steadily on back of increasing digital music sales

Source: ICICIdirect Research

Exhibit 14: Improving Return ratios



Source: ICICIdirect Research

Valuations

We expect Saregama to once again dominate the Indian music industry and replicate its dominant performance which it had shown for decades. Given the robust growth in the high margin business like publishing and home video coupled with effectively utilization of the music library we expect Saregama to command high valuations given its high earnings visibility. At the current price of Rs 302, the stock is available at an EV/EBIDTA of 16.06x FY08E earnings and 9.34x FY09E earnings. The stock trades at a P/E of 21.15x FY08E EPS of Rs14.28 and 16.77x FY09E EPS of Rs 18.01, which is well below the average media industry P/E of 22x.

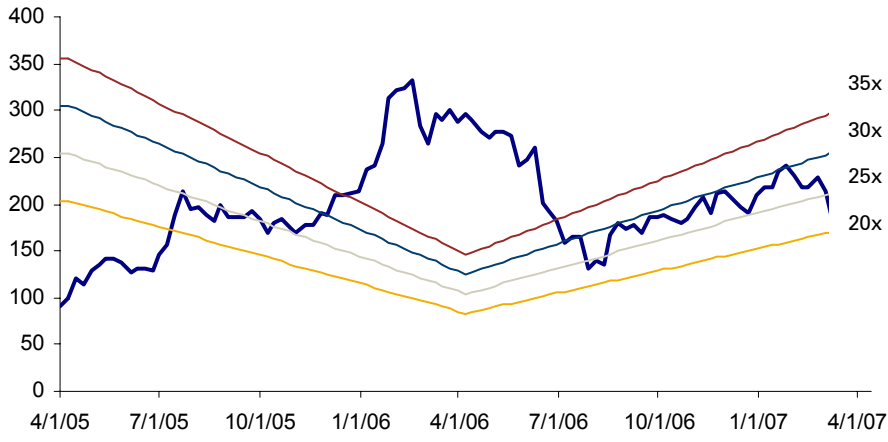
We believe there is no benchmark valuation for Saregama as there are no other players having the dominance and reach that it commands in India. Global music companies are also richly valued and trade anywhere between 25-35x FY08E earnings as shown. Even considering the historic PE band it can be seen that Saregama trades above 25x earnings similar to the global counterparts and other Indian media companies having dominant position in their space. However, considering that the company still gets significant portion of its revenues from physical sales and is yet to scale up the digital business to a critical level we give it a 10% discount and initiate coverage on the company with an Outperformer rating and expect it to be valued at Rs 405, 22.5x FY09E.

Exhibit 15: Global Peer Comparison

FY09E	EV/EBIDTA	P/E	ROE	OPM
Warner Music	8.3	33	77.6	15.60%
EMI	7.8	25	1.53	14.10%
Saregama	9.3	16.7	19.38	19.84%

Source: Consensus Estimates, ICICIdirect Research

Exhibit 16: Historical PE Band



Source: ICICIdirect Research

Profit & Loss Account

	(Rs Crore)			
(Year-end March)	FY09E	FY08E	FY07	FY06
Sales	201.01	172.53	141.54	126.59
% Growth	16.51%	21.90%	11.81%	-
Op Profit	39.88	24.83	13.29	7.82
% Growth	60.63%	86.81%	69.95%	-
Other Income	4.80	5.20	7.17	4.79
Depreciation	4.76	4.49	4.24	3.98
EBIT	39.92	25.54	16.22	8.63
% Growth	56.29%	57.45%	87.95%	-
Interest	0.60	0.60	0.60	0.90
Profit before Tax	39.32	24.94	15.62	7.73
% Growth	57.65%	59.66%	102.07%	-
Taxation	12.39	3.49	2.25	1.37
Net Profit	26.92	21.45	13.37	6.36
% Change YoY	25.53%	60.41%	110.22%	-
Net Profit after minority interest	26.42	20.95	13.01	6.11

Balance Sheet

	(Rs Crore)			
(Year-end March)	FY09E	FY08E	FY07E	FY06
Cash	46.84	14.78	4.07	8.33
Trade Receivables	50.25	43.13	35.39	29.38
Loans & Advances	35.71	32.46	29.51	26.83
Investments	27.65	33.65	39.65	47.65
Gross Block	86.60	81.60	76.60	68.61
Net Block	45.50	45.26	44.75	41.00
Capital Work-in-progress	15.00	10.00	3.00	0.00
Current Liabilities & Provisions	110.43	92.53	80.85	88.50
Total Asset	145.53	118.61	103.93	105.70
Loans	4.00	4.00	4.00	6.03
Equity Share Capital	14.67	14.67	14.67	14.67
Reserves & Surplus	121.66	95.24	81.06	81.16
Total Liabilities	145.53	118.61	103.93	105.70

Cash Flows

(Rs Crore)

(Year-end March)	FY09E	FY08E	FY07E	FY06
Profit after Tax	26.92	21.45	13.37	6.36
Misc exp w/o	0.00	0.00	0.00	-0.01
Depn	4.76	4.49	4.24	3.98
Cash Flow before WC Changes	31.68	25.93	17.61	10.33
Net Increase in Current Liabilities	17.91	11.68	-7.65	-5.76
Net Increase in Current Assets	13.53	14.14	9.10	1.43
Cash Flow after WC Changes	36.06	23.47	0.86	3.14
Purchase of Fixed Assets	10.00	12.00	10.99	2.90
(Increase) / Decrease in Investment	6.00	6.00	8.00	-8.15
Cash Flow from Investing Activities	-4.00	-6.00	-2.99	-11.05
Increase / (Decrease) in Loan Funds	0.00	0.00	-2.03	-16.56
Increase / (Decrease) in Equity Capital	0.00	-6.77	-0.10	23.86
Cash Flow from Financing Activities	0.00	-6.77	-2.13	7.30
Op bal Cash & Cash equivalents	14.78	4.07	8.33	8.94
Closing Cash/ Cash Equivalent	46.84	14.78	4.07	8.33

Ratios

(Year-end March)	FY09E	FY08E	FY07E	FY06
EPS	18.01	14.28	8.87	4.16
Cash EPS	21.26	17.34	11.76	6.88
Book Value	92.93	74.92	65.02	56.22
Operating Profit Per Share	27.18	16.92	9.06	5.33
Operating Margin (%)	19.84%	14.39%	9.39%	6.18%
Net Profit Margin (%)	12.84%	11.79%	8.75%	4.65%
RONW	19.38%	19.06%	13.64%	7.41%
ROCE	27.08%	21.11%	15.31%	9.08%
Debt Equity	0.03	0.04	0.04	0.07
Enterprise Value	372.54	398.61	403.31	393.08
EV/EBIDTA	9.34	16.06	30.35	50.27
Sales to Equity	13.70	11.76	9.65	8.63
Market Cap	443.03	443.03	443.03	443.03
Market Cap to sales	2.20	2.57	3.13	3.50
Price to Book Value	3.25	4.03	4.64	5.37
PE	16.77	21.15	34.05	72.51
Dividend Per Share	0.00	0.00	0.00	0.00
Dividend Yield (%)	0.00	0.00	0.00	0.00

RATING RATIONALE

ICICIDirect endeavours to provide objective opinions and recommendations. ICICIdirect assigns ratings to its stocks according to their notional target price vs current market price and then categorises them as Outperformer, Performer, Hold, and Underperformer. The performance horizon is 2 years unless specified and the notional target price is defined as the analysts' valuation for a stock.

Outperformer: 20% or more;

Performer: Between 10% and 20%;

Hold: $\pm 10\%$ return;

Underperformer: -10% or more.

Harendra Kumar

Head - Research & Advisory

harendra.kumar@icicidirect.com

**ICICIdirect Research Desk,
ICICI Securities Limited,
2nd Floor, Stanrose House,
Appasaheb Marathe Marg,
Prabhadevi, Mumbai – 400 025**

research@icicidirect.com

Disclaimer

The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities Ltd (I-Sec). The author of the report does not hold any investment in any of the companies mentioned in this report. I-Sec may be holding a small number of shares/position in the above-referred companies as on date of release of this report. This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and may not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This report may not be taken in substitution for the exercise of independent judgement by any recipient. The recipient should independently evaluate the investment risks. I-Sec and affiliates accept no liabilities for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Actual results may differ materially from those set forth in projections. I-Sec may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject I-Sec and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.