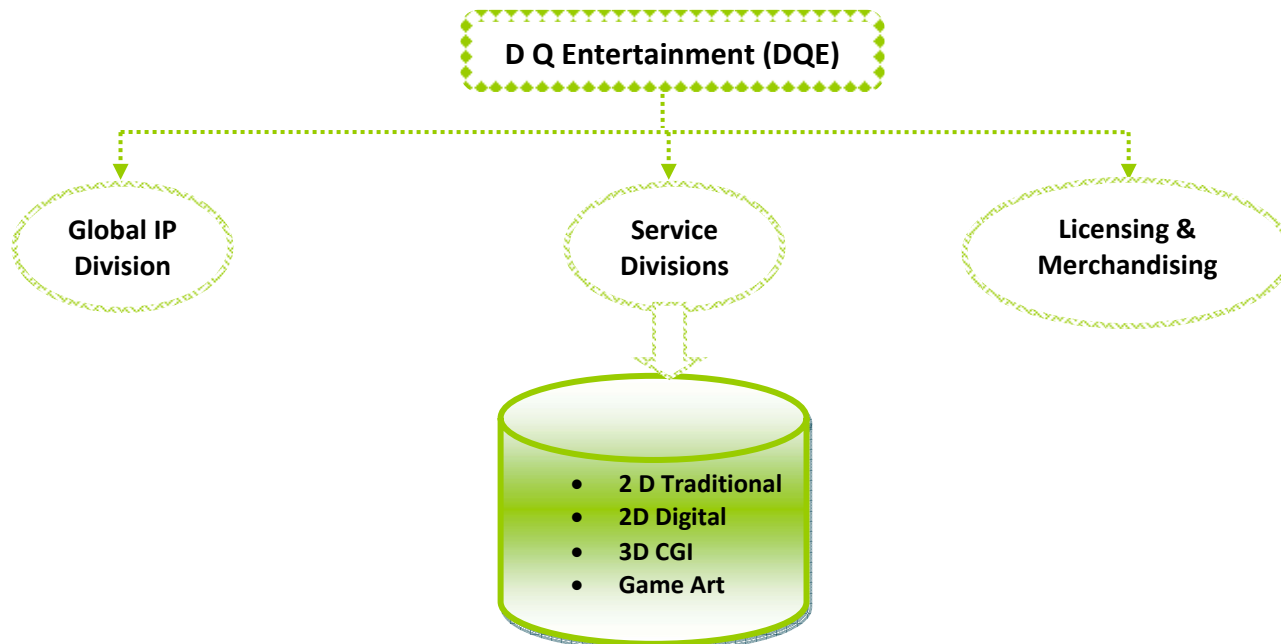


**IPO Note**
**DQ Entertainment (International) Ltd.**

<b>Recommendation</b>	<b>SUBSCRIBE</b>	<p><b>Background</b></p> <p>DQ Entertainment was incorporated as “Animation and Multimedia Pvt. Ltd.” to undertake the production of animation, visual effects, game art and entertainment content for the Indian as well as global media and entertainment industry. Mr. Tapaas Chakravarti, the promoter of the company has an experience of over ten years in the animation, media and entertainment industry.</p> <p><b>Brief Overview of DQ entertainment</b></p> <ul style="list-style-type: none"> <li>• In 2000, the erstwhile DQ Entertainment Ltd established an in-house training centre to train production staff to deliver high quality animation productions to European and North American clients.</li> <li>• In 2002, it established traditional 2D animation studio.</li> <li>• In 2003-2004, the company established 2D digital pipeline and started securing commissions to produce full animation series.</li> <li>• In 2004, it established 3D animation production process and the first commercial 3D animation project was a French TV series “Les Gnoufs” for Method Animation SAS, France</li> <li>• In 2007, the company began engagement in game assets development</li> </ul> <p>The company has also ventured into developing its own IP (<i>The Jungle Book, Balkand, Omkar and Ravan</i>) in the year 2009. DQ entertainment has 10 production facilities in India (8 in Hyderabad and 1 each in Mumbai and Kolkata). It has a talent pool of 2851 employees and world-wide third party sales representatives in Paris, Tokyo and Los Angeles. It set up DQ School of Visual Arts in the year 2008 to address the demand for high quality animation and gaming professionals. The company has an asset base of 350 hours of animation content from which it earns revenues through licensing and distribution activities.</p>
<b>Price Band</b>	<b>Rs 75 – Rs 80</b>	
<b>Bidding Date</b>	<b>8<sup>th</sup>–10<sup>th</sup> Mar, 2010</b>	
<b>Book Running Lead Manager</b>	<b>SBI Capital Markets Ltd.</b>	
<b>Sector</b>	<b>Media &amp; Entertainment</b>	
<b>Retail Application- Detail At Cut off Price</b>		
Number of Shares	1200	
Application Money	96000	
Amount Payable	96000	
<b>Valuation</b>		
Diluted EV/ EBITDA (U/L)*	14.7/13.8	
Diluted P/E (U/L)*	31.3/29.3	
<b>No of Equity Shares Offered</b>		
	1.604 Cr	
<b>Post Issue Promoter Holding</b>		
	75.00%	
<b>Offer structure for different categories</b>		
QIB	At least 60.00%	
Non-Institutional	Up to 10.00%	
Retail	Up to 30.00%	
Lot Size	80	
Post issue Equity (Rs. in Cr)	79.28	
Issue Size (Rs. in crores)	120.36 – 128.38	
Face Value (Rs.)	10	
Kunal Dalal, AVP – Equity Research Ph –(022)-3027 2212 E-Mail: <a href="mailto:kunal.dalal@nirmalbang.com">kunal.dalal@nirmalbang.com</a>  Durgesh Poyekar (022)-3027 2239 E-Mail: <a href="mailto:durgesh.poyekar@nirmalbang.com">durgesh.poyekar@nirmalbang.com</a>  *(U/L) Upper and lower band		

**Business Model**



**Objects of the issue**

The issue comprises of 1.604 Cr equity shares of face value of Rs10 with a price band of Rs 75 and Rs 80. The issue size is Rs 128.38 Cr at the upper price band & Rs 120.36 Cr at the lower price band.

**Proceeds of the issue will be used for:**

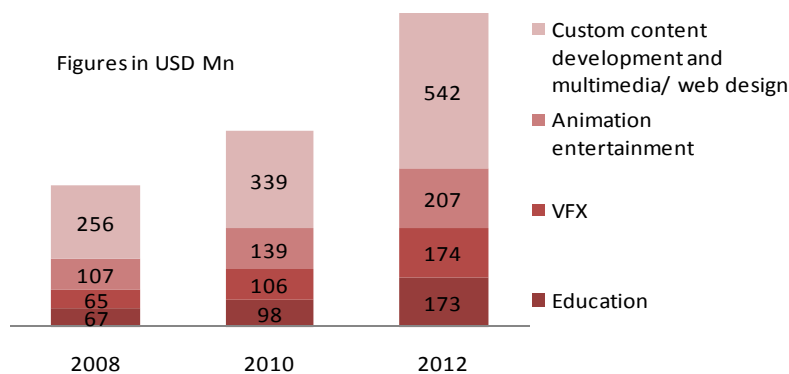
- Rs 54.95 Cr to be used in investment in co-production agreements, focusing on IP content creation
- Rs 39.23 Cr to be used in development of office premises and production facilities; development of infrastructure and additional facilities at the SEZ Unit, Kokapet Village, Rangareddy District, Andhra Pradesh
- Rs 14.59 Cr to be used in investment in the subsidiary, DQ Entertainment(Ireland) Limited
- General corporate purposes.

Recently the company has raised Rs 25.69 Cr through pre- IPO placement of Equity Shares by allotting an aggregate of 37,72,771 Equity Shares at the price of Rs 68.11 per share to a group of investors led by IDFC Investment Advisors.

**Investment Rationale**

- DQ Entertainment has high levels of earning visibility with a robust order book of UD\$ 95.07 Mn. More than 40% of the order book is already in various stages of production & balance to commence during the year. The company expects to execute US\$ 28 Mn in FY10 and the balance beyond FY10. The momentum of revenue growth is expected to be maintained for FY10 and FY11.
- The company has highly skilled workforce of 2851 employees which includes 2580 employees directly involved in production activities, enabling the company to undertake multiple large and manpower intensive projects. The company has set up The DQ School of Visual Arts, wherein the company has 3 centres at Hyderabad, Mumbai & Kolkatta. The school has till date trained 715 people & caters to the specialized man power requirements of the company.
- The entire animation industry in India was estimated at USD 314 Mn in 2006 & USD 494 Mn in 2008. Increased outsourcing from overseas countries due to India's inherent cost advantage, maturity of international animation studios, emphasis on IP (intellectual property) creation will give a boost to this Industry to reach USD 1 Bn by 2012 at a CAGR of 22%. We believe DQ Entertainment Ltd. will be a major beneficiary of this growth due to its international experience and expertise in the domestic industry. The animation industry in India can be classified into following key segments: animation entertainment, animation education, custom content development and multimedia/web design and VFX.

**Animation Industry in India**



Source: Company RHP and Nirmal Bang Research

- With a well diversified client base of over 90 companies including internationally recognized brands such as, inter alia, the Disney Group, Nickelodeon, American Greetings, BBC, Moonscoop Group, ZDF-Germany, Australian Broadcasting Corporation and NBC Universal, the company is not heavily dependent on any single client.

- The company has strategically moved along the animation value chain, gaining greater exposure to intellectual property ownership and distribution, thereby realizing better margins. The company is entering into co-production arrangements to minimize its risks. As a result, it not only continues to receive production revenues generating its usual production margin, but also acquire rights to earn license revenues.
- In future the company will diversify its range of offerings by including pre-production and post-production services that will add value to the current service offerings and would earn a larger share of the revenues collected from the IPs that the company will produce/co-produce.
- The company plans to increase its revenue stream by strengthening its games division by investing into research and development for computer games applications and developing porting and testing facilities for console based games.
- The global animation market was estimated at US\$ 68 Bn in 2008 and is expected to grow at a CAGR of 10 per cent to reach US\$ 100 Bn by 2012.

#### **Investment Concerns**

- Despite the large number available graduates to work in the industry, a large proportion of such people are not employment ready and do not have the requisite skill sets. Due to the low availability of skilled labour the attrition rate is high which impacts the salary costs and project continuity. Global animation industry is growing and is highly competitive. Thus a lot depends upon the ability of company to acquire and retain talent.
- The revenue growth of the company is dependent upon its ability to win more and more new contracts which are difficult to predict. Therefore, the future results of operations and cash flows can fluctuate materially from period to period depending on the timing of contract awards.
- The company has recently ventured into the business of developing its own IP content. The company may not be able to manage its foray effectively which can affect the business prospects of the company.
- The company faces tough competition from international animation production companies from the USA, Europe, Canada, UK etc such as Aardman Animation, The Mooncoop Group, Porchlight Entertainment etc. and companies based out of south-east Asia, like Korea, Taiwan and Philippines.
- DQ Entertainment has a significant portion of its revenue from select geographical regions. In 2009 41.57% of revenue came from US and 51.18% came from European nations. Any adverse economic impact in such regions will significantly affect the revenues and the profit of the company.

**Recommendation**

DQ Entertainment Ltd is available at a P/E multiple of 31.3x & 29.3x FY10E (H1 FY10 annualized) at the upper and lower price band respectively on post issue capital, which looks expensive. The profitability in the first half results of the current year was exceptional when compared to last few years, which is a positive sign for the company. The company looks all set to grow in the next few years with a huge number of new initiatives expected in animation segment & IP creation over next 2-3 years. Though the current valuations look steep, if profitability of first half is maintained going ahead, the valuations might be justified. We therefore recommend to Subscribe to the issue with a medium term view.

**Financials**
**Income Statement**

Particulars (Rs. Cr.)	FY08*	FY09	6M FY10
Income from Operations	92.2	149.8	70.5
Total expenditure	69.4	97.2	47.9
EBITDA	22.8	52.6	22.6
EBITDA Margins	25%	35%	32%
Depreciation	12.7	28.2	12.4
EBIT	10.1	24.4	10.2
EBIT Margins	11%	16%	15%
Other income	2.4	1.1	3.2
Interest	4.3	5.6	2.7
Adjustment on account of restatement			0.1
PBT	8.1	19.9	10.8
Total Tax	1.1	3.8	0.6
Profit after tax before extraordinary items	7.0	16.1	10.2
Impact of material adjustments for restatement in corresponding years	0.0	0.1	-0.1
Extraordinary itmes (net of tax)			
Profit after tax and extraordinary items	7.0	16.0	10.2
PAT Margins	8%	11%	14%
EPS	0.9	2.0	1.3

\* FY08 are standalone figures

Source: Nirmal Bang Research

**Balance Sheet**

Particulars (Rs. Cr.)	FY08*	FY09	6M FY10
<b>SOURCES OF FUNDS</b>			
Share Capital	1.6	1.6	59.5
Reserves and Surplus	128.4	144.5	96.8
Networth	130.1	146.1	156.2
Secured Loans	40.4	36.5	27.3
Unsecured Loans			10.5
Total Debt	40.4	36.5	37.8
Deferred Tax Liability		1.2	
<b>TOTAL</b>	<b>170.4</b>	<b>183.8</b>	<b>194.1</b>
<b>APPLICATION OF FUNDS</b>			
<b>Fixed Assets</b>			
Gross Block	100.3	135.0	175.4
Less: Accumulated Depreciation	35.6	58.7	66.9
Net Block	64.7	76.4	108.5
Capital WIP	35.7	62.7	44.2
<b>Sub total</b>	<b>100.4</b>	<b>139.0</b>	<b>152.7</b>
<b>Current Assets, Loans and Advances</b>			
Sundry Debtors	23.1	41.6	54.3
Unbilled Revenue	20.9	18.4	19.6
Cash and Bank Balances	42.9	10.5	7.6
Loans and Advances	7.9	8.9	19.5
<b>Sub total</b>	<b>94.8</b>	<b>79.4</b>	<b>101.1</b>
Current Liabilities	17.0	25.5	50.8
Provisions	7.8	9.1	8.9
Net Current Assets	70.0	44.8	41.4
<b>TOTAL</b>	<b>170.4</b>	<b>183.8</b>	<b>194.1</b>

\* FY08 are standalone figures

Source: Nirmal Bang Research

**NOTE**

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