

HUM NETWORK LIMITED (HUMNL)

Approaching an Inflection Point

April 26, 2022



Investment Summary

■ Valuation & Recommendation

- We initiate soft coverage on Hum Network Ltd (HUMNL) with price target of PKR 14.5/share, which offers an upside of 71% from its last closing of PKR 8.5/share. The stock trades at FY22E PER of 5.3x (FY14-21 avg: 14.7x) and FY22E PBV of 1.68x (FY14-21 avg: 4.3x). The company also offers a dividend yield of 9.4%. Helped by shrinking losses in the news segment and rising Youtube revenues, we expect HUMNL's FY22 EPS to rise 53% YoY to PKR 1.6.

■ Steep growth in “Hum News” ad revenue; shrinking losses

- While 1HFY22 News segment revenues grew 130% YoY, news segment cost remained flat during the period. Breakeven is expected in 2HFY22 led by contained cost while upward adjustment in advertisement rate by 40% will further augment news channel revenue.

■ Youtube subscription revenue are on a strong uptrend

- Rising Youtube subscriptions have opened up a new avenue for monetization of HUMNL's large cache of quality content. This is a huge upside considering that the production costs are largely expensed out.

■ Stable entertainment segment

- HUMNL's entertainment segment's ad revenue is a well-established revenue engine. With the continued recovery in corporate profits, growth in ad spend will likely continue going forward.

■ Weak governance is a key risk

- Sponsors have a very generous fixed and variable compensation structure. Sponsors' remuneration has ranged between 17% to 26% of pretax earnings (before sponsors remuneration) during FY14-FY21.
- HUMNL procures a significant share of its content from its related party. However, primary margins have been higher in the years in which share of related party content procurement rose.
- The management took active steps to thwart a group of activist shareholders seeking board representation in CY20.

Valuation & Recommendation

- Valuation and expected return
 - Our price target for HUMNL of PKR 14.5/share, offers an upside of 71% from its last closing of PKR 8.5/share. The company also offers a dividend yield of 9.4%.
 - Our price target (PT) has been computed using an equal weighted blend of HUMNL’s historical average PE, PBV and P/S ratios. We have applied a 30% discount to the fair value implied by the historical average PE, PBV and P/S in order to account for the ongoing market pessimism and HUMNL’s higher governance risks.
- Risks
 - Weak governance
 - Decline in marketing spending by business due to overall economic slowdown or abrupt rise in cost of doing business could result in lower ad revenues for HUMNL.
- About soft coverage universe
 - HUMNL is the first stock that we have added to our Soft Coverage universe. Our soft coverage aims to balance detailed orientation with timeliness. Companies added to soft coverage universe are usually approaching a turnaround and generally not actively covered by the peers and hence the soft coverage aims to add value by increasing investor awareness.
 - Valuation is based on comparative methods (detailed coverage usually include discounted cashflows) and forecast is limited to current years financial statements (detailed coverage usually include 5–10-year forecast)

Key Financial Ratios

	FY17A	FY18A	FY19A	FY20A	FY21A	FY22E
EPS	1.1	0.9	(0.7)	(0.2)	1.1	1.6
EPS growth	110.3%	-17.5%	NM	NM	NM	52.7%
DPS	0.1	-	-	-	-	0.8
Dividend yield	1.2%	-	-	-	-	9.4%
Gross Margins	42.9%	38.0%	12.6%	21.9%	36.2%	48.1%
PER	7.9	9.5	(12.5)	(41.6)	8.1	5.3
P/B	2.7	2.1	2.5	2.6	2.0	1.7
ROE	34.6%	22.4%	-19.8%	-8.1%	24.0%	31.6%

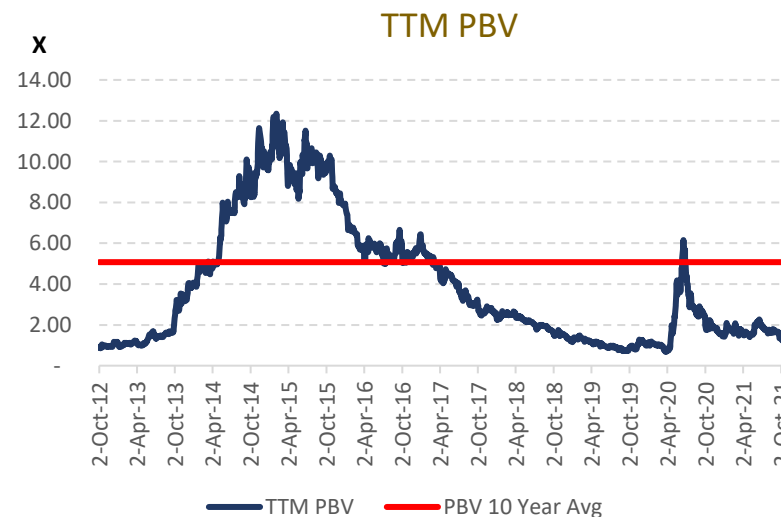
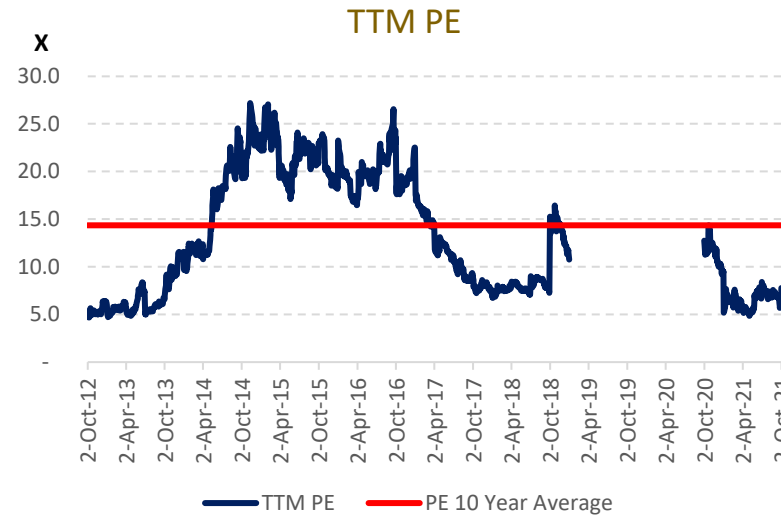
Valuation Table

	FY22E	Avg Multiple*	PT	Weightage
BVPS	5.1	4.3	21.9	33%
Sales/share	7.0	2.1	14.8	33%
EPS	5.3	14.7	25.6	33%
Weightage Average Fairvalue			20.8	
Less: Discount			30%	
Weighted Average PT			14.5	

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Valuation & Recommendation

- HUMNL's PE and PBV multiples are attractive when compared to its historical averages
 - HUMNL is currently trading at trailing P/BV of 1.8x, which is at a significant discount of 44% to its 7-year average P/BV of 3.2x.
 - The company is trading at a TTM PE 7.1x, resulting in a discount of 31% to FY14-18 PE of 10.4x.
- Regional comparison
 - HUMNL's PE and P/BV discount to its regional companies currently stands at 30% and 5%, respectively.
 - The company is also trading at P/S of 1.41x, which is a significant discount of 45% to its regional peers.



Regional Comparison

Country	Company Name	PE	PBV	P/S
India	TV today Network	13.55	2.33	2.73
India	Zee Ent. Enterprise	24.47	2.50	3.31
India	Sun Tv Network Ltd	11.41	2.56	5.56
Indonesia	Surya Citra Media	5.44	2.49	3.14
Indonesia	Media Nusantara Citra	5.80	0.81	1.61
Indonesia	Global Mediacom	3.14	0.31	0.32
Malaysia	Media Prima	12.35	1.08	0.61
Thailand	Tv thunder	8.00	1.59	3.33
Average		10.52	1.71	2.58
Pakistan	Hum Network	7.38	1.63	1.41
Discount		-30%	-5%	-45%

3QFY22 Result Review

- HUMNL posted profit after tax of PKR 362.9mn (EPS PKR 0.38) in 3QFY22, up 2.2x YoY, compared to profit after tax of PKR 114.5 (EPS PKR 0.12) in 3QFY21. This takes 9MFY22 earnings to PKR 1.0bn (EPS PKR 1.1) compared to earnings of PKR 0.7bn (EPS PKR 0.8) during 9MFY21.
- Along with the result, the company also announced an interim dividend of PKR 0.35/share.
- The company reported 55% YoY growth in revenue to PKR 1.67bn during 3QFY22 compared to PKR 1.07bn in 3QFY21. We believe, revenue from entertainment segment is likely to increase by 54% YoY to PKR 1.5bn while news segment revenue is anticipated to grow by 107% YoY to PKR 134mn during 3QFY22.
- While revenue continues to grow, the company has successfully rationalized the cost in last few years. Consequently, 3QFY22 Gross profit margin clocked in at 47.0% compared to 36.6% in 3QFY21.
- Since company's sponsors have a very generous share of compensation structure (both fixed and variable), admin expenses rose in tandem with the increase in profits and grew 73% YoY to PKR 236mn in 3QFY22 compared to PKR 137mn in 3QFY21, restricting the bottom-line of the company.

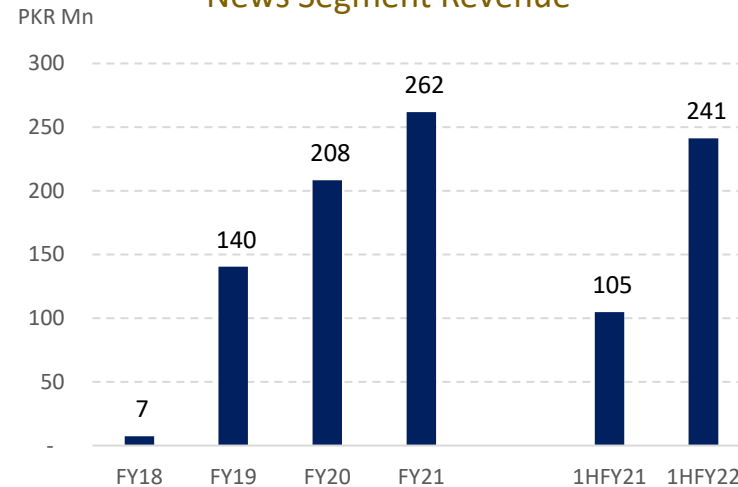
Financial Highlights (PKR mn)

	3QFY21	3QFY22	YoY	9MFY21	9MFY22	YoY
Net sales	1,079	1,677	55%	3,579	4,681	31%
Gross Profit	395	788	99%	1,330	2,282	72%
Dist. Expense	131	138	5%	369	312	-15%
Admin Expense	137	236	73%	616	703	14%
Other income	39	10	-76%	77	41	-47%
Finance cost	26	22	-17%	79	57	-28%
Profit before tax	140	382	173%	819	1,196	46%
Profit after tax	115	363	217%	760	1,060	39%
EPS	0.12	0.38	217%	0.80	1.12	39%
DPS	-	0.35	-	-	0.35	-

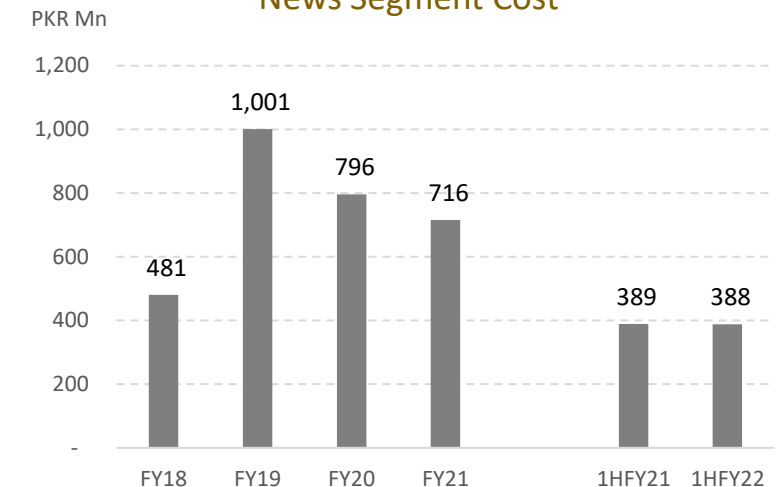
Steep growth in “Hum News” ad revenue; shrinking losses

- Hum News, started in May 2018, led to a substantial increase in costs, with very little additional ad revenue in the initial years.
- Since then, Hum News ad revenue has increased sharply and is one of the key drivers of topline growth for HUMNL. The company has also rationalized News channel’s costs with FY21 news segment expense being 28% lower than FY19. While 1HFY22 News segment revenues grew 130% YoY, news segment cost remained flat during the period.
- As a result, News segment losses have fallen sharply from PKR 860mn in FY19 to PKR 454mn in FY21. News segment losses further fell by 48% YoY in 1HFY22.
- Furthermore, Government has revised the advertisement rate for Hum News upward by 40% to PKR 140,000 per minute, which will further augment news channel revenue during 2HFY22 onwards.

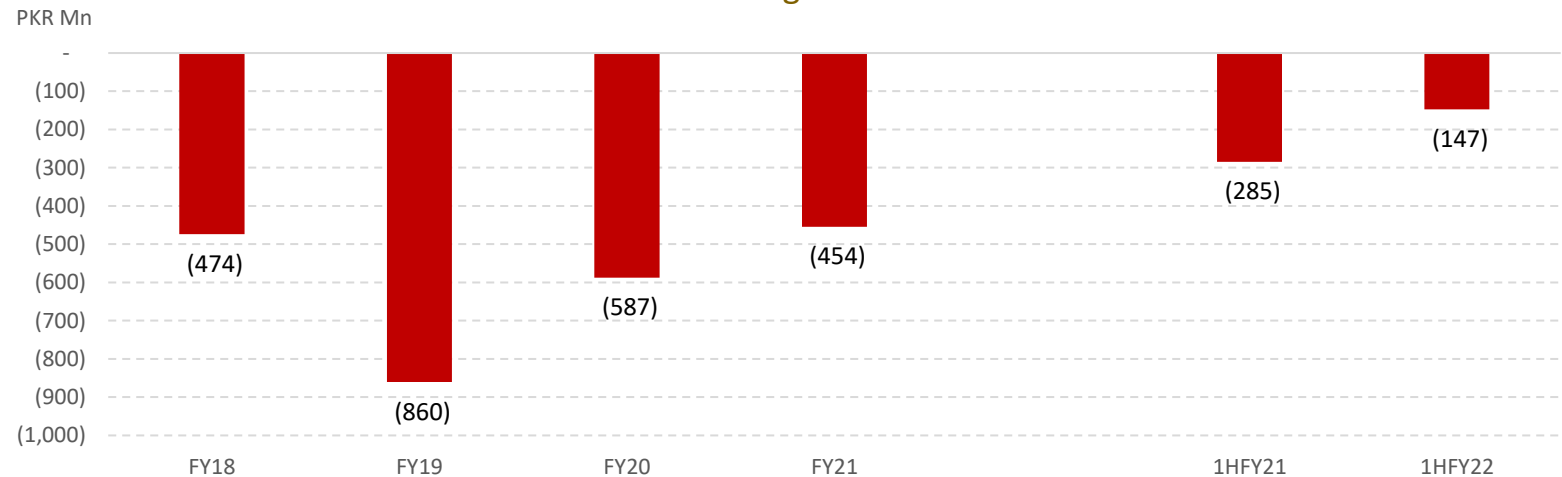
News Segment Revenue



News Segment Cost

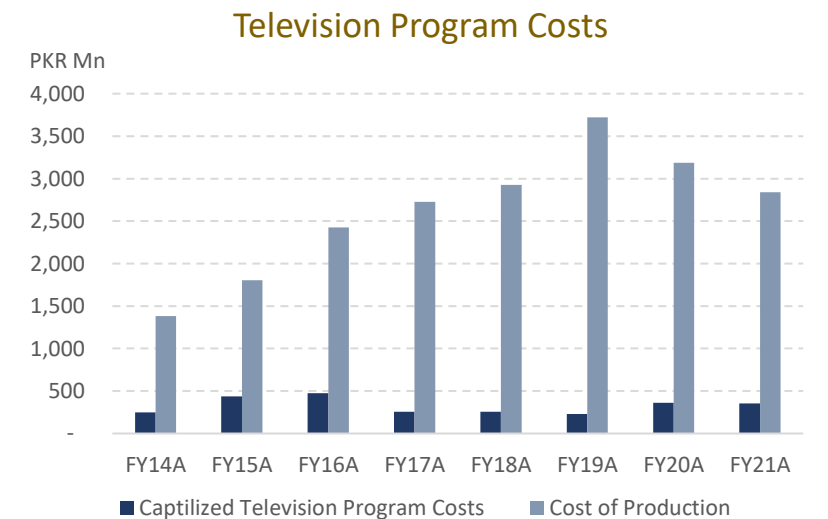
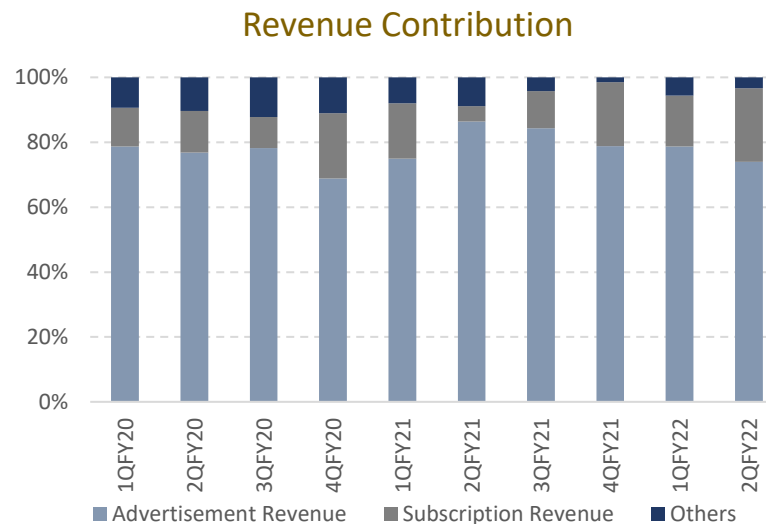
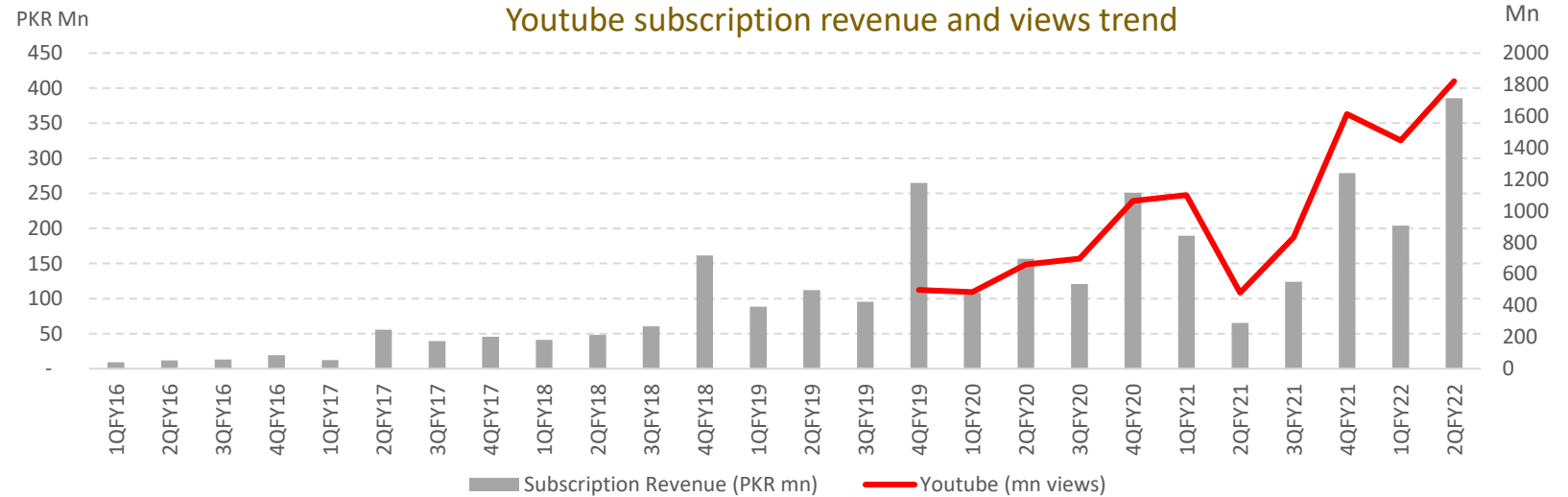


News Segment Loss



Subscription revenue are on a strong uptrend

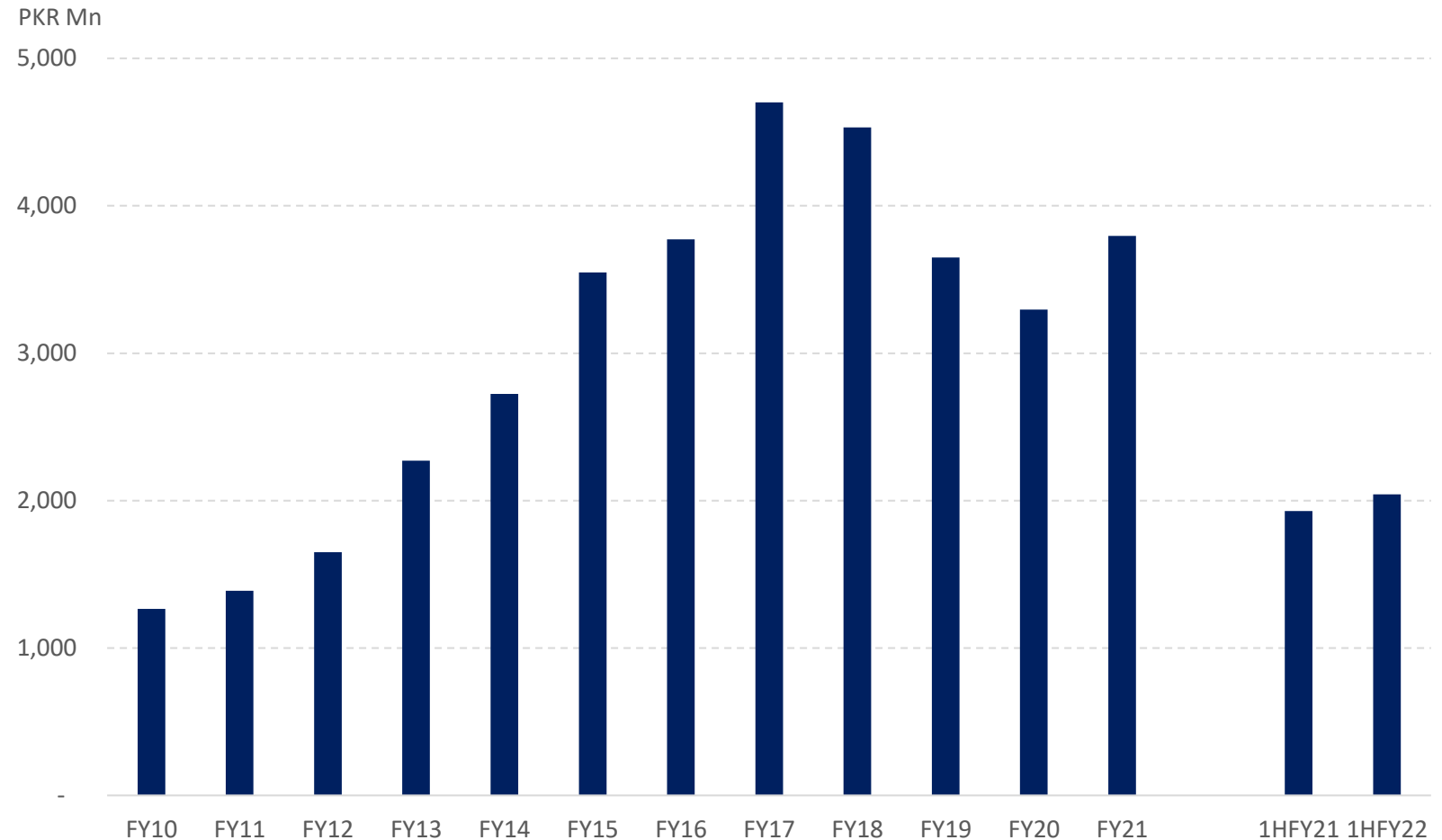
- Rising Youtube viewership / subscription has led to a steep rise in HUMNL's subscription revenue, which rose to PKR 386mn in 2QFY22 compared to PKR 65mn in 2QFY21. Subscription revenue's contribution to total revenue has risen to 23% in 2QFY22 vs 5% in 2QFY21.
- Rising Youtube subscriptions have opened up a new avenue for monetization of HUMNL's large cache of quality content, which didn't have a clear monetization route. This is a huge upside considering that the propriety content is not recorded as an asset on balance sheet as production costs are largely expensed.
- Hum TV is one of the most popular entertainment channels in Pakistan due to its quality of content.



Stable entertainment segment's ad revenues

- HUMNL's entertainment segment's ad revenue is a well-established revenue engine. However, with fully saturated airtime and pricing, growth opportunity remains weak.
- Entertainment segment ad revenue fell by 27% between FY18-20 due to economic slowdown and weak business environment affecting advertiser's ad spend. However, entertainment segment revenue rose 6% YoY in 1HFY22, after having risen by 15% YoY in FY21.
- With the continued recovery in corporate profits, growth in ad spend will likely continue going forward, and help support growth in HUMNL's entertainment segment's ad revenue.

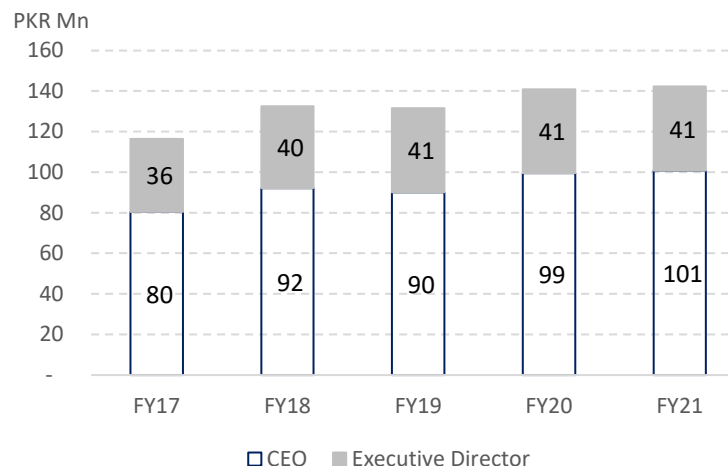
Entertainment segment ad revenue



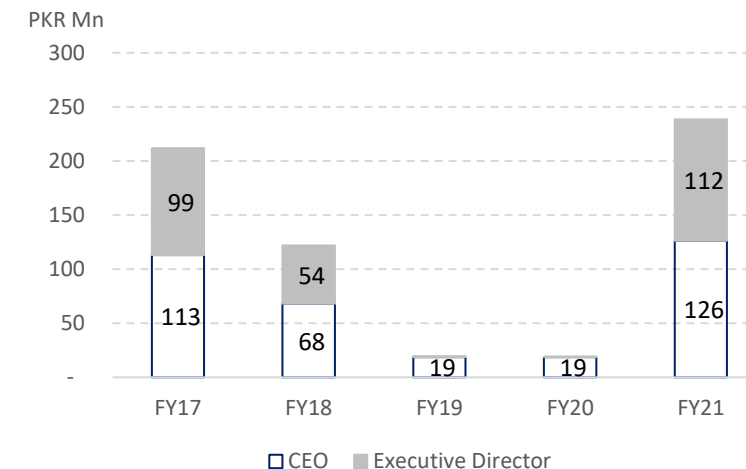
Governance Issue 1: High sponsor salaries and bonuses

- HUMNL’s sponsors / senior management (CEO + Executive Director; hereinafter referred to as “sponsors”) have a very generous fixed and variable compensation structure with the latter linked to ROE. Sponsors’ remuneration has ranged between 17% to 26% of pretax earnings (before sponsors remuneration) during FY14-FY21 with ROEs ranging between 24% to 41%.
- Sponsors’ compensation totaled PKR 381mn in FY21, 26% of pretax earnings before sponsors’ remuneration. FY21 ROE was 24%.
- Very high payouts for sponsor / senior management in the shape of salaries and bonuses, eliminate their dependance on dividends which puts minority shareholders at a disadvantage.
- Additionally, the fact that content cost is expensed leads to underreporting of equity base for content owning media companies. As such, variable compensations should have a higher ROE threshold.

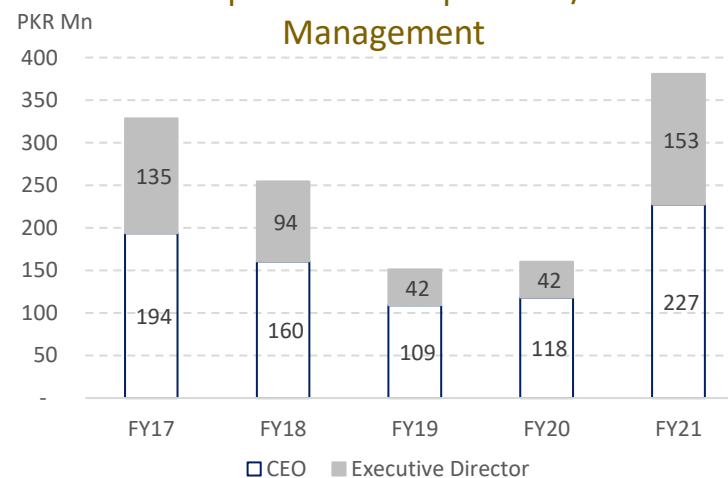
Fixed Compensation



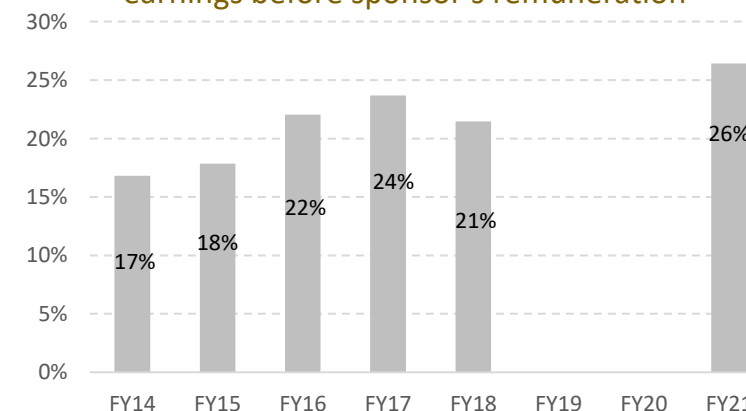
Variable Compensation



Total Compensation of Sponsors / Senior Management



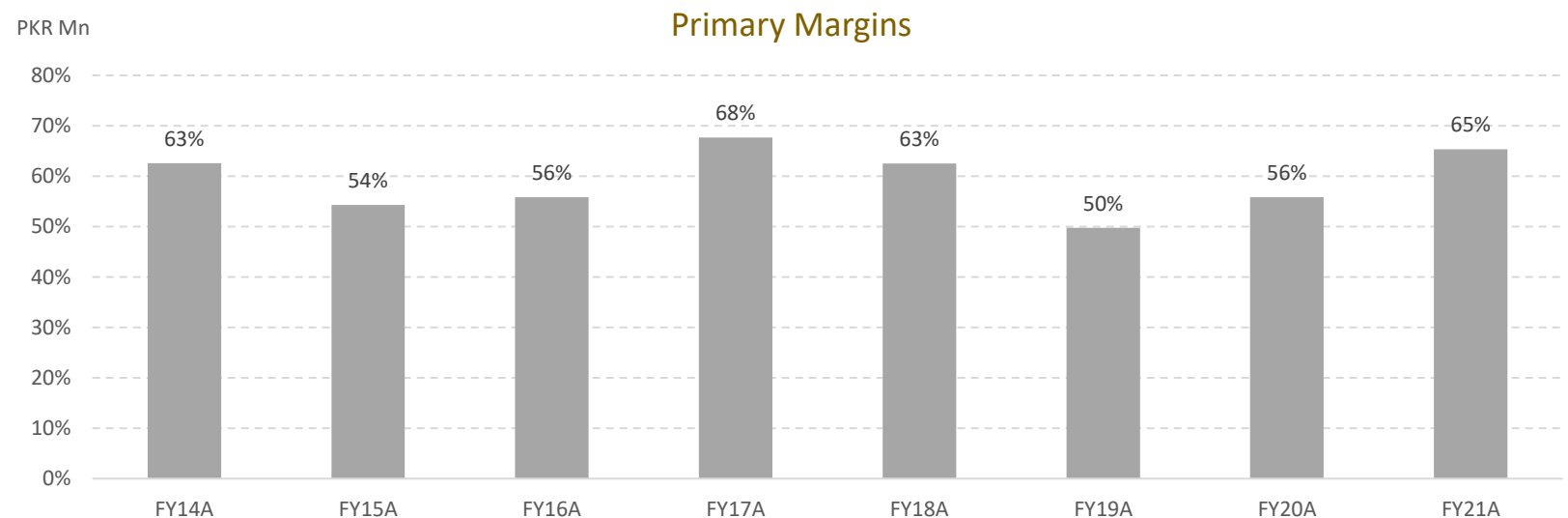
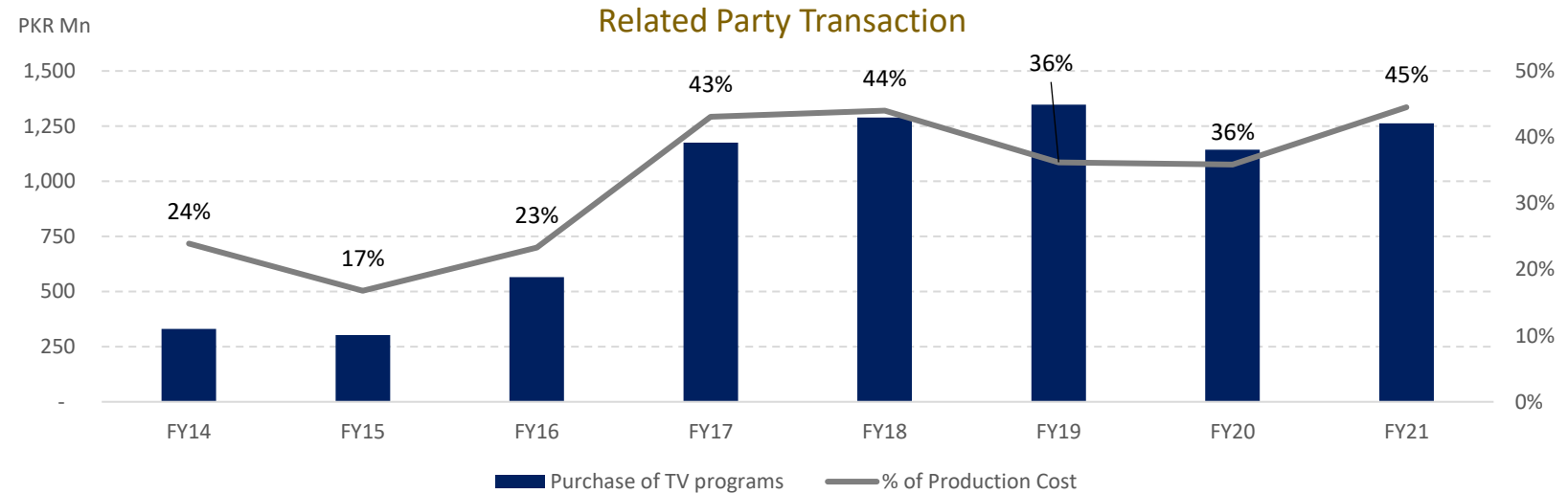
Sponsor’s remuneration as a % of pretax earnings before sponsor’s remuneration



Note: Company incur losses during FY19 & 20 despite adjusting sponsor’s remuneration

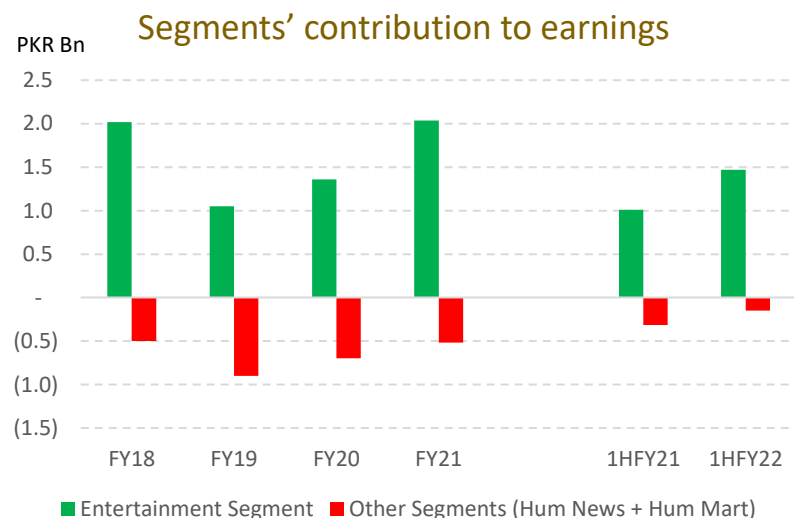
Governance Issue 2: Content procurement from related party

- The company procures a significant share of its content from its related party, MD productions, which is owned by the spouse of HUMNL’s CEO.
- As a result, the company has a very high share of related party transactions in its cost structure.
- HUMNL procured PKR 1.26bn of content from its related party during FY21 which was 45% of total cost of production compared to 24% in FY14.
- However, increase in share of related party content acquisition doesn’t seem to hurt margins. In fact, primary margins have been higher in the years in which content procurement from related party rose. Primary margins of the company varied between 50% to 68% during FY14-21.

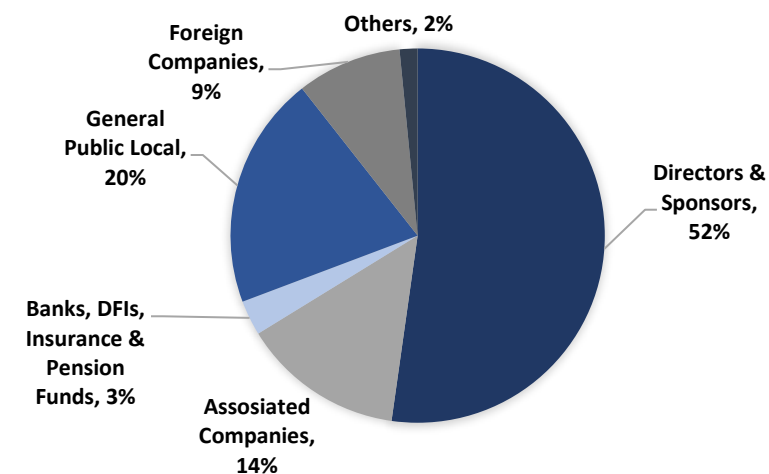


Governance Issue 3: Failed recent shareholder activism

- During 2014 Kingsway fund acquired 21.3% shareholding in HUMNL. Most of the shares were purchased from the CEO and sponsors of HUMNL.
- Since then, the profitability of the company increased at a CAGR of 22% during FY15-17. However, higher loss contribution from Hum news and Hum mart along with COVID-19 induced weak business environment dragged the company into losses during FY19-20.
- During April-June 2020, Kingsway fund and JS group entered into a share transfer arrangement which led to speculation about change in management control of HUMNL. Consequently, the share price of HUMNL increased to PKR 17.1 per share from PKR 2.3 per share within a span of 2.5 months.



Shareholding Before Kingsway, Jun-14



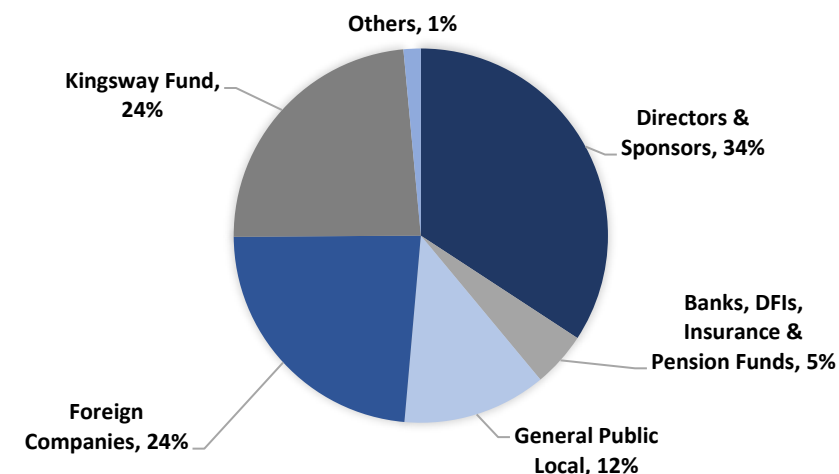
Share Price trend after Kingsway acquisition



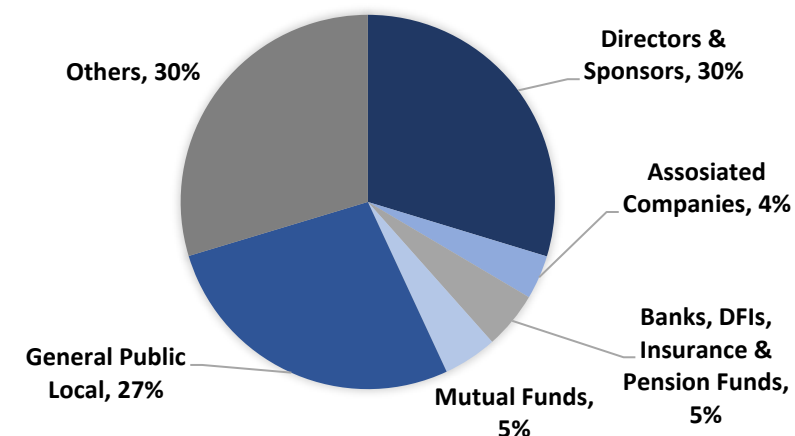
Governance Issue 3: Failed recent shareholder activism (continued)

- The abnormal movement in the company’s share price was primarily driven by upcoming elections.
- There were several large transactions between
 - Aitkenstuart Pakistan Pvt Ltd (APPL), a subsidiary of OBS group, acquired 83.5mn shares of HUMNL (8.83% of the total issued capital of HUMNL).
 - During May-20 & Jun-20, APPL sold 79.0mn shares to JS Bank limited, 34mn shares to Jahangir Siddiqui & Sons limited and 1.1mn shares to Mr. Munaf Ibrahim.
 - Munaf Ibrahim then sold 16.5mn shares to Kingsway Capital on June 3, 2020.
- After the above transactions, the combined shareholding of the above entities increased to 33% of the issued capital of HUMNL as of June 30, 2020. During FY20, Kingsway increased its shareholding to 20.7% vs 16.3% in FY19.
- HUMNL received 15 applications following the announcement of elections of BoD. The company in its notice informed that 6 persons directly and indirectly belong to JS group. The company rejected all such applications. However, 2 persons went to court and got a stay order on board meeting and the company had to postpone its election.
- Later, Kingsway sold all its holding in Nov-20 at a share price of PKR 6.0 worth PKR 1.2bn.
- In Dec-21, CEO HUMNL made a public announcement to acquire up to 332.2mn shares (35.15% of the total capital) at an offer price of PKR 7.0/share. The public offer ended in Feb-22, in which minority shareholders tendered 202.5mn shares.

Shareholding after Kingsway’s investment, Jun-15



Shareholding after Kingsway divestment, Jun-21



Financial Highlights

HUMNL	FY16	FY17	FY18	FY19	FY20	FY21
Income Statement (PKR mn)						
Net sales	4,229	5,105	5,192	4,787	4,645	4,994
Gross Profit	1,569	2,188	1,973	604	1,017	1,809
Distri & A	909	1,026	1,113	1,168	1,055	1,217
Other income	120	87	134	204	277	163
Finance cost	40	22	34	144	245	102
Profit after tax	487	1,023	844	(645)	(193)	995
Balance sheet (PKR mn)						
Non-Current Assets	949	811	2,148	2,080	2,152	1,865
Current assets	2,317	2,783	3,488	3,919	3,187	3,764
Total Assets	3,266	3,594	5,636	5,999	5,339	5,629
Non-Current liabilities	27	12	1,107	990	971	395
Current liabilities	1,301	625	764	1,732	1,326	1,224
Total Liabilities	1,328	638	1,871	2,722	2,297	1,619
Equity	1,938	2,957	3,764	3,277	3,042	4,011
Total Equity & liabilities	3,266	3,594	5,636	5,999	5,339	5,629

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To arrive at our 12-months Price Target, the JV uses different valuation methods which include: 1). DCF methodology, 2). Relative valuation methodology, and 3). Asset-based valuation methodology.

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JV employs a three-tier ratings system to rate a stock, as mentioned below, which is based upon the level of expected return for a specific stock. The rating is based on the following with time horizon of 12-months.

Rating	Expected Total Return
Buy	Greater than or equal to +15%
Hold	Between -5% and +15%
Sell	Less than or equal to -5%

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