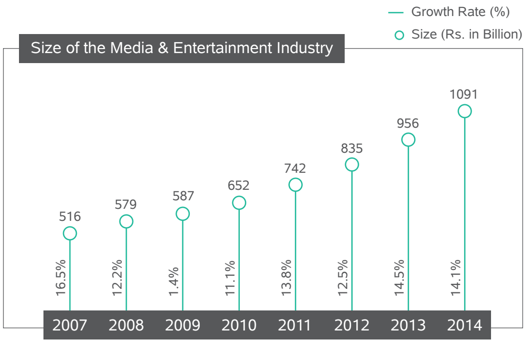
MANAGEMENT DISCUSSION AND ANALYSIS

MEDIA AND ENTERTAINMENT INDUSTRY

2009 was a difficult year for the media and entertainment industry, as the overall economy passed through a slowdown. Advertising, which constitutes 38% of the industry's revenue, declined significantly on account of shrinking ad budgets in the corporate world. Sectors like films, radio and out-of-home media (OOH) recorded negative growth during the year. However, the television industry witnessed decent growth, along with the internet, gaming and animation industries touching double digit growth, albeit on a smaller base. Hence, the industry as a whole grew marginally by 1.4% to Rs. 58,700 crores, against a 12% growth in 2008. With improvement in liquidity and global economies, showing a sign of recovery, India's GDP is expected to touch 9% annually by 2011-12, according to the Economic Advisory Council. The media and entertainment industry is, therefore, estimated to register 13% CAGR for the next five years, till 2014.

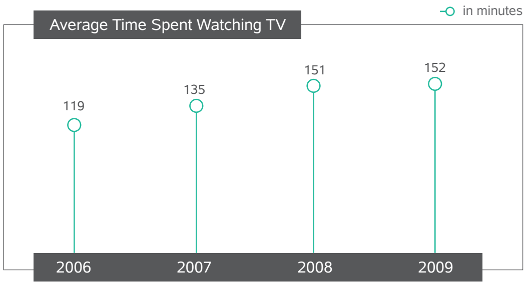


(Source : FICCI-KPMG Indian Media & Entertainment Industry Report 2010)

Traditionally, India's total media spend has been significantly lower compared to other countries globally. In fact, at 0.40%, the media spend, as a percentage of GDP, is almost half of the world's average of 0.80%, and is much lower compared to developed countries like the US and Japan. Even a country like China with the world's largest population, enjoys a media spend ratio at 0.75%, in line with the world average. This indicates the potential India holds for growth in spends, going forward. Even though it is challenging to reach the levels of countries like the US, Japan and UK, due to a very large population base and lower spending power per capita, there is an ample scope to follow China and enhance this ratio.

TELEVISION INDUSTRY

Television is the largest segment of the Indian M&E industry, representing over 40% share of the total market. Today, 50 crore Indians depend on television as a source of mass entertainment, and this figure is rising, thanks to consistent fall in prices of TV sets and aggressive cable and satellite distribution in untapped areas. Of the total 12.9 crore TV households, 9.5 crore households possess a cable connection. As per reliable research, on an average, an individual daily spends two and a half hours watching TV.



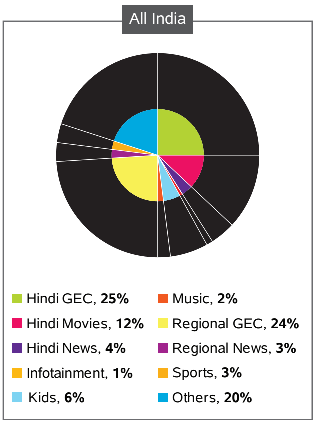
(Source : FICCI-KPMG Indian Media & Entertainment Industry Report 2010)

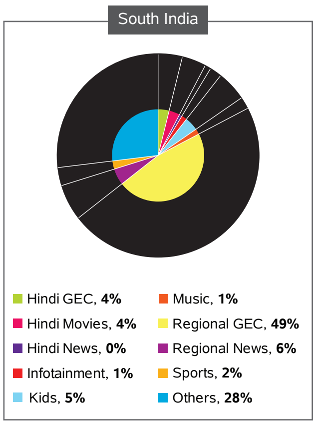
Despite the economic challenges of 2009, the television industry grew modestly (6.6%) becoming a Rs. 25,700-crore market. With growing demand for different genres and niches (news, kids, infotainment and lifestyle) the absolute number of channels increased from 120 in 2003 to over 460 in 2009. There has been a greater acceptability for niche channels in 2009, such as lifestyle-based channels (IMAGINE Good Times, Discovery Travel & Living), youth-based channels (UTV Bindaas, MTV) and channels focusing on male audiences (UTV Action). Moreover, 'Regionalization' has become the industry's new buzzword with rapid rise in literacy, consumption and

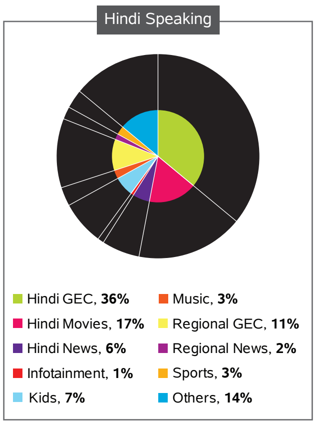
disposable incomes in Tier 2 and Tier 3 cities. Advertisers have also enhanced their rural focus, following urban market fascination. Besides, demand for regional content is also growing. No wonder, broadcasters and content creators are equally keen to capitalise on this opportunity. Interestingly, the Hindi General Entertainment Channel (GEC) genre attracted 25% viewership, followed by Regional GEC (24%) and Hindi movies genre (12%). The balance 39% viewership was divided among news, music, sports and kids. However, more precisely in the Hindi speaking belt the Hindi GEC genre enjoyed 36% viewership and in South India the Regional GEC genre enjoyed 49% viewership. In terms of content, 2009 witnessed the share of reality TV rising on popular GEC channels. Shows like *'Sach ka Samna', 'Khatron ke Khiladi', 'Rakhi ka Swayamvar'* and *'Pati Patni aur Woh'* targeted both the female and the male audiences.

Besides, the singing and dancing competition format shows strengthening popularity. However, the fiction genre continued to dominate as daily soaps ruled the GECs. But socially relevant and regionalized / rural content were increasingly favoured. There is a growing amount of industry fragmentation due to the introduction of newer genres and expansion of the channel universe. The viewers are exposed to attractive options and hence have become more demanding. Gone are the days, when the highest rated shows could get TRPs (Television Rating points) as high as 20 points. On the back of rapid change in audience preferences, the lifespan of a show reduced to one to two years. Moreover, due to intense competition and pressure from advertisers, broadcasters have also become impatient in continuing to air a low-rated show.

VIEWERSHIP SHARE BY GENRES



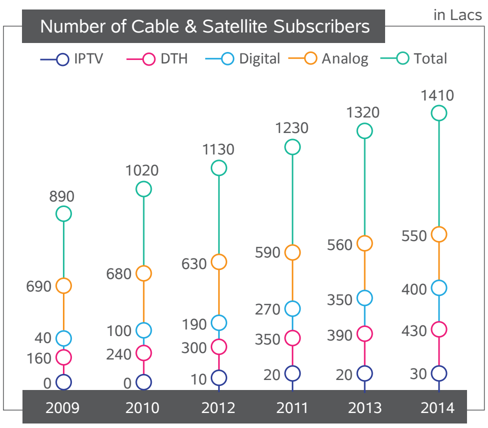




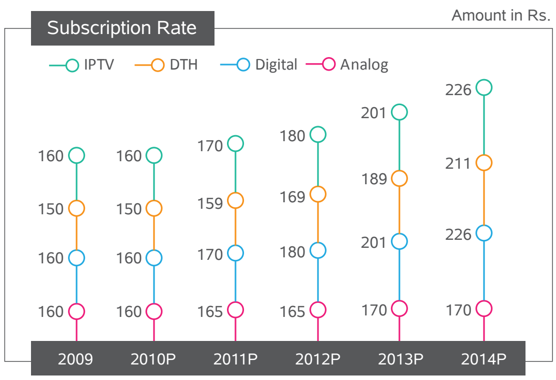
(Source : FICCI-KPMG Indian Media & Entertainment Industry Report 2010)

> The growth in subscription revenue will be mainly due to digitization, which brings about more transparency in the declaration process apart from rising penetration. The (Direct-To-Home) DTH television connections are expected to reach 4.3 crore connections by 2014.

Going forward, considering the fast recovery in Indian economy, the television industry is estimated to grow at a CAGR of 15% to attain a size of Rs. 52,100 crores by 2014. The two contributors, subscription and advertisement are expected to grow more or less at 15% and maintain a 65:35 mix. The growth in subscription revenue will be mainly due to digitization, which brings about more transparency in the declaration process apart from rising penetration. The (Direct-To-Home) DTH television connections are expected to increase at a CAGR of 22% to 4.3 crore connections by 2014. On the other hand, the digital cable connection is projected to rise to 4 crores by 2014 recording a CAGR of 60%. Hence, the share of analogue cable connection, which stands at a whopping 80% is anticipated to decline to 40% by 2014. Besides, Internet Protocol television (IPTV) holds a huge potential, but may take time to grow due to very low internet penetration in India.



(Source : FICCI-KPMG Indian Media & Entertainment Industry Report 2010)



(Source : FICCI-KPMG Indian Media & Entertainment Industry Report 2010)

Hence, differentiation is key to survival in the competitive television industry, good concepts, differentiated genres, interactive game shows, experimentation with newer formats and shows, exploring new talent, will help to manage and compete with the growing number of shows, channels and genres on Indian Television.

MOTION PICTURES

India is the only country which averages a release of three films everyday in some or the other language. To watch these movies nearly 300 crore movie tickets are sold in India, nearly double of that of USA. Moreover, films form one of the most important content sources to the Music, Radio and Television industries.

Historically, the Indian film industry represents 18% of the total media and entertainment industry. However, 2009 was one of the worst years for the film industry, facing unprecedented losses on account of the stand-off between the Multiplex Owners and Film Producers. The cold war between the exhibitors and producers, which lasted for two months stalled several movie releases in

multiplexes. With more than 1000 screens, multiplexes constitute 60% of total revenue from Hindi film exhibition. So although, they reached an amicable solution eventually the damage was already done. For the first time the overall film industry shrunk by 14.4% from Rs. 10,400 crores in 2008 to Rs. 8,900 crores in 2009. It also was hit because of the general recession and low acceptance of below par content, churned by production houses as compared to previous years. As per industry reports, the year 2009 had only four blockbusters out of 242 Hindi films, released during the year. The industry gets three fourth of the revenue from domestic theatrical exhibition and the balance through home videos, cable and satellite rights, overseas exhibition and other avenues like release on DTH. On the piracy front, following in the footsteps of the Tamil Nadu government, the Maharashtra and Karnataka governments also amended an Act to curb film and music piracy. As per experts, films industry is losing close to a whopping Rs. 4000 crores (Business Standard - 2nd Oct 2009) because of piracy, which is 40% of the current industry size.

Barring 2009, the film industry is estimated to grow at CAGR of 9% for the coming five years to become an almost Rs. 14,000-crore industry. All the three industry verticals i.e. production, distribution and exhibition, have their own dynamics, but the exhibition part is expected to be the main growth driver. Rising popularity and development of multiplexes, even in small cities and towns will not only improve the volume, due to better viewing experience, but will also lead to higher average realization per ticket. Growing disposable incomes, favourable demographic changes, increase in the number of films targeted at niche audiences and entertainment tax benefits granted by various states are contributing to the growth of multiplexes. As per the current rate, by 2013 India is likely to have over 1,600 screens, double of what we have currently. In addition, miniplex operators have their own plans to develop 500 miniplexes in next few years.

On the distribution side, digitization has significantly benefited the industry. The distributors can release large number of prints across geographies simultaneously and in much shorter time. Simultaneously, it also saves the significant cost of developing the traditional physical prints. In fact, the whole film industry is moving towards the triple 'D' structure, which means digital production, digital post production and digital release.

Globally, 2009 was a remarkable year because it saw the release of James Cameron's Avatar in 2D and 3D format, which became the first film ever to gross over USD 2 billion worldwide. This highlights the potential of films as an entertainment source. Hence, continued interest by global studios in India, investments in technology such as 3D and digitization, introduction of miniplexes, coupled with strong government support against piracy is likely to help the Indian film industry strengthen its position in the years to come.

NEW MEDIA BUSINESS

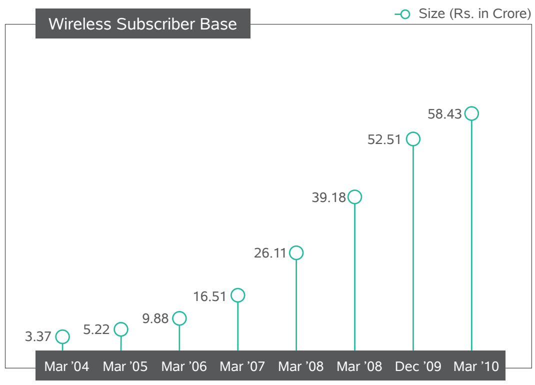
Traditionally, the media and entertainment space was ruled by only two screens - big screen (cinema) and small screen (television). However, in the last few years computer screens and mobile screens have rapidly grown as a destination of entertainment, referred to as 'new media'. Consumers are now looking upon the personal computer (PC) and cell phone as an alternative source to entertainment. There have been ground-breaking innovations, such as Broadband, Bluetooth,

> With 3G services to be rolled out by next year, the VAS industry is expected to increase its share manifold, with some industry estimates pegging the figure at Rs. 200 billion by 2015.

Wi-Fi, Wi-Max and 3G (Third Generation), among others that support disparate forms of content. Similar developments were witnessed in the domain of devices that are designed to support such networks. Mobile handsets are getting more sophisticated, sleeker and more advanced in terms of powerful processors, increased memory space, larger screens, open operating systems and offering features that were unimaginable earlier. Hence, the new media is revolutionizing the consumer market, reconciling the functionalities of customer end terminal devices like TV, PCs and mobile phones. Such devices are witnessing exponential demand growth among teenagers and professionals with high disposable income. Mobile Value Added Service (VAS) has become a significant business driver for service providers, with potential to grow attractively in future.

The VAS market, currently valued at Rs. 65 billion (USD 1.35 billion), constitutes about 9-10% of the total revenues for telecom operators in India with short messaging service (SMS) alone accounting for 44% of that share. With 3G services to be rolled out by next year, the VAS industry is expected to increase its share manifold, with some industry estimates pegging the figure at Rs. 200 billion by 2015 *(Source: Gartner)*.

India's telecom industry grew at 60% CAGR (Source: COAI and Gartner) in the last five years, one of the highest compared to the world's other telecom markets. Interestingly, India is the world's second largest telecom market after China with a 60 crore-plus mobile subscriber base (wireless subscriber base increased from 584.32 million in March 2010 to 601.22 million at the end of April-2010, registering 2.89% growth). Wireless tele-density stands at 50.98 (Source: www.telecomindiaonline.com).



(Source: Internet & Mobile Association of India)

During April 2010, India's telecom industry witnessed a landmark government decision, as it finally declared auction of 3G spectrum and invited open bids from telecom companies across India. 3G is the latest technology, which provides various advantages such as high data transfer rates, map and positioning services, multiplayer gaming and enables high-resolution video and multimedia services with streaming audio and video capabilities opening up business opportunities in the space of Mobile TV and Mobile Video.

On the other hand, India's internet use witnessed steady growth. PC users in urban areas have increased from 5.9 crore in 2006 to around 10 crore (Source: www.internetworldstats.com).Today every telecommunication provider is providing internet service packaged with other services at affordable rates. With sprawling cyber cafes and easy availability of broadband connection, internet is now in reach of common individuals. Concurrently, internet usage on the move is also gaining fast user acceptance by the high-speed



data cards, public Wi-Fi hot spots and internet access on mobile phone.

As per Internet and Mobile Association of India, almost 75% of urban PC users claim to be accessing internet for information and entertainment. In fact, internet as a medium for socializing and leisure activities like downloading music and videos are gaining incredible popularity, compared with other services. Even the advertisers are making higher allocation towards internet advertising, leveraging this growing trend. All these factors augur well for content providers like Balaji.

SCOT ANALYSIS

Strength

- High Production Capabilities
- Huge infrastructure
- Talent Hunting / Artist Management
- Pioneers in creating special Content for Mobile
- Solid Financial Position
- Strong Presence across Hindi, Tamil, Telegu, Malayalam & Kannada. Only production house to have the shows on air in 9 different channels
- A good mix of sponsored & commissioned shows
- Integrated film maker - Production, Marketing & Distribution of films
- Stringent Risk Management practices.

Challenges

- High Cost of Production against industry average
- Concentrated Clients
- Dependence on few key people for concept & creativity
- Genre specific presence - mainly in fiction

Opportunities

- Create content for other regional languages / international market
- Enter non fiction, reality segments
- Monetization of content through other delivery platforms
- Expand presence in digital space

Threats

- Rising Competition
- Piracy
- Gaining popularity of other entertainment options like sports, gaming, internet, malls, travelling etc
- Change in Government Policies
- Rising Labour Cost & Energy Cost

"Internet as a medium for socializing and leisure activities like downloading music and videos are gaining incredible popularity, compared with other services."

RISK MANAGEMENT

Risk type	Risk implication	Risk mitigation
Market risks		
Economic slowdown risk	Corporates may reduce their advertising budget for television, jeopardizing per-hour realizations.	Balaji has implemented strict cost control initiatives per episode. The Company evaluates and analyzes the risk-reward scenario before commencing film production or any other major project.
Competition risk	Rising competition may reduce bargaining power with channels.	Balaji is the undisputed leader in the Hindi GEC space and enjoys strong brand recognition with shows commanding a good premium.
Risk of unfavourable government policies	Any unprecedented change in government policy may increase the overall cost.	Balaji is suitably positioned to absorb, recover or pass on the rise in taxes to channels, distributors or exhibitors.
Business risks		
Single-channel dependence risk	Dependence on a single channel may be detrimental to business	Balaji now enjoys a strong presence across five Hindi GEC, with not over 30% revenue from any one channel.
Risk of changing audience preferences	Rapid change in viewer tastes and preferences can impact business adversely.	Balaji's dedicated team conducts research to understand evolving audience preferences. One result of such an effort is the new media business.
Human resource risk		
Talent retention and management risk	The business depends on key talent (story writers, creative heads, lead artists, directors, technicians, among others). Non-availability of such resources could impact business.	Balaji has always attracted the best of talent in the industry. It has created stars and transformed artists' careers.

OPERATIONAL OVERVIEW

An analysis of the Company's operations is included on page 26-31 of this annual report.

Internal Control Systems and Adequacy

Balaji has a well-defined organisational structure and a strong Internal Audit process for maximum utilisation of its resources and safeguarding the same from misuse. The Company has a strong internal audit program, exercised through a Docket Management System. An independent commercial team further controls the hiring and requisitions of materials, which allows enhanced focus on operational efficiencies. The Company's Audit Committee, along with the Board regularly review the operations and adequacies of internal controls on an ongoing basis.

FINANCIAL REVIEW

Results of operation

Turnover

The total turnover for 2009-10 declined by 48% to Rs. 15,282.41 Lacs from Rs. 29,491.89 Lacs in 2008-09 on account of a sharp decline in realization per hour, coupled with a considerable drop in programming hours of content for the commissioned show. Revenue contribution from commissioned shows was Rs. 12,800 Lacs from Rs. 26,844 Lacs in 2008-09, while that of sponsored programming was Rs. 2,444 Lacs from Rs. 2,648 Lacs in the same period. The share of commissioned shows in the revenues during 2009-10 was 84% while that of sponsored shows was 16%.

Other income

The other income for 2009-10 increased by 26% to Rs. 2,197.76 Lacs from Rs. 1,738.34 Lacs in 2008-09 on account of write back of excess provision of doubtful debts which were written off earlier.

Cost of production of television serials

There was a 41% decrease in cost of production of television serials to Rs. 10,606.67 Lacs for 2009-10 from Rs. 18,066.38 Lacs for 2008-09 because only 763 hours of content for commissioned show was created during the year from 929 hours in 2008-09. Moreover, the Company has also been able to successfully bring down the average cost of production per hour by adopting stringent cost control measures.

Employee costs

Although the company has brought down its manpower in absolute terms but the total employee cost for 2009-10 went up by 24% to Rs. 1,637.90 Lacs from Rs. 1,320.41 Lacs in 2008-09 as the Company hired experienced talent at the senior management level.

Selling, General and Administrative expenses

On the back of lower provisioning for doubtful debts and no provisions for diminution in value of long term investments, the total Administrative and other expense declined in 2009-10 by 49% to Rs. 3,096.30 Lacs from Rs. 6,128.49 Lacs in 2008-09.

Depreciation

The depreciation for 2009-10 stood at Rs. 1,033.43 Lacs from Rs. 2,352.26 Lacs in 2008-09. Last year one of the sets was depreciated at an accelerated rate (Impact Rs. 953 Lacs), being exclusively carried out for a serial which went off air.

> Revenue contribution from commissioned shows was Rs. 12,800 Lacs from Rs. 26,844 Lacs in 2008-09, while that of sponsored programming was Rs. 2,444 Lacs from Rs. 2,648 Lacs in the same period.

Profit before tax

The profit before tax recorded a decline of 41% to Rs. 2,225.27 Lacs in 2009-10 from Rs. 3,751.38 Lacs in 2008-09 as the total revenue fell sharply by 48%. However, due to rise in other income the impact was mitigated to some extent.

Profit after tax

The profit after tax for 2009-10 decreased by 42% to Rs. 1,519.09 Lacs from Rs.2,632.12 Lacs in 2008-09.

FINANCIAL POSITION

Share Capital

As no capital was raised during 2009-10 the paid up share capital remained same at Rs. 1,304.21 Lacs.

Reserves & Surplus

The reserves and surplus increased by a modest 3% to Rs 38,873.91 in 2009-10 from Rs.37,583.71 Lacs in 2008-09.

Fixed Asset

The Gross Block in 2009-10 increased significantly by 52% to Rs. 14,880.85 Lacs from Rs. 9,813.60 Lacs in 2008-09, on account of addition of land bought within the limits of Mira Bhayander Municipal Corporation for the purpose of building its studio.

The net block increased by 101% to Rs. 8,131.11 Lacs in 2009-10 from Rs. 4,045.16 Lacs in 2008-09. This increase is on account of increase of Gross Fixed Assets.

The capital work in progress stood at Rs.289.93 Lacs for 2009-10 from Rs. 5,138.99 Lacs.

Investments

The investments of the Company decreased by 15% in 2009-10 to Rs. 20,978.66 Lacs from Rs 24,567.32 in 2008-09 on account of funding to the subsidiary company in line with the business plans. The investments include Rs. 3,000 Lacs invested in the wholly owned subsidiary, Balaji Motion Pictures Limited.

Working Capital

During 2009-10, the Company granted loan to the subsidiary company because of which the Loans & Advances for 2009-10 increased to Rs. 7,489.01 Lacs from Rs. 2,301.00 Lacs in 2008-09. On the other hand, the Company repaid its creditors which led to 38% decline in Current Liabilities to Rs. 2,199.90 Lacs in 2009-10 from Rs 3,548.85 Lacs in 2008-09. Hence, the working capital of the Company for 2009-10 recorded a rise of 131% to Rs. 10,869.58 Lacs from Rs. 4,707.00 Lacs in 2008-09.

FUTURE STRATEGIES

Corporate Level

- Grow beyond being a television content provider
- Further strengthen the professional identity
- De-risk and Diversify Revenue Model (channels, regional programming, other business divisions)
- Establish ALT and Hoonur as recognized brands
- Expand management bandwidth

Television

- Maintain and consolidate the leadership in fiction space
- Launch new shows with different and new story lines at regular intervals
- Capture viewership beyond the prime time bands in major GECs, in non-prime hours, weekends and other channels
- Foray into creation of other Regional content like Marathi and Bangla
- Constantly analyze and evaluate the change in viewer preferences.
- Improve the type of show mix (horror, comedy, fiction, reality)
- Continue strict control on cost of production

Films

- Rapidly scale-up film business
- Create strategic template to produce and market larger number of films every year to enable strong pipeline and capability-building
- Align with best-in-class writing and directing talent to generate superior scripts and film content
- Span entire spectrum of film offerings from mass commercial to urban niche to address large and growing audience segments
- Consolidate marketing capability to build competitive advantage in the industry
- Kick-start development initiative at grass root level - first-time directors / actors / script writers
- Ramp up capabilities on distribution - domestic and international
- Emerge as a leading integrated production house with downstream integration into distribution and marketing of films.

New Media

- Strengthen the Hoonur brand
- Develop hoonur.com as a full entertainment portal
- Monetization of Hoonur.com through subscriptions
- Consolidate and increase tie-ups with telecom companies for mobile contents
- Create 'mobisodes' for reputed brands.

Education

- Establish and stabilize this new venture
- Create a strong brand in education field as well
- Differentiate by delivering globally bench marked content in an innovative method.
- Gradually scale this business across India
- Regularly broadbase its product offering