UFO Moviez India Limited
Q4 & FY16 Earnings Conference Call

May 27, 2016

MANAGEMENT:
SANJAY GAIKWAD – MANAGING DIRECTOR, UFO MOVIEZ INDIA LTD
KAPIL AGARWAL – JOINT MANAGING DIRECTOR, UFO MOVIEZ INDIA LTD
ASHISH MALUSHTE – CHIEF FINANCIAL OFFICER, UFO MOVIEZ INDIA LTD

ANALYST:
ANKUR PERIWAL – RESEARCH ANALYST, AXIS CAPITAL LTD

Moderator: Ladies and gentlemen, good day and welcome to the UFO Moviez India Limited Q4&FY16 Earnings Conference Call, hosted by Axis Capital. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Ankur Periwal from Axis Capital. Thank you and over to you Mr. Periwal.

Ankur Periwal: Thank You. Good day ladies and gentlemen. On behalf of Axis Capital, I welcome you all to UFO Moviez India Limited's Q4&FY16 Earnings Conference Call. The Company is today represented by Mr. Sanjay Gaikwad – Founder and Managing Director, Mr. Kapil Agarwal – Joint Managing Director and Mr. Ashish Malushte – Chief Financial Officer.

I would now like to hand over the call to Mr. Gaikwad for his opening remarks, post which we can start the question and answer session. Thank you and over to you.

Sanjay Gaikwad: Thank you, Ankur and thank you all for joining our Q4&FY16 earning call. Before taking questions, I am going to give a brief overview of our performance for the financial year ended March 31, 2016.

So let's start, we saw continued strength in our advertising revenues with 35% growth in line with our annual guidance. We delivered over 55% ad growth during the quarter to achieve our annual guidance. The theatrical business continued to deliver stable results.

Our consolidated financial performance factors in the planned losses from new business initiatives like Caravan Talkies which is under our subsidiary VDSPL. Despite planned losses in VDSPL, our overall consolidated performance has been very encouraging. Total consolidated revenue grew 19.4 % to ₹5,721 million. The primary factor driving this growth was advertising, higher E Cinema VPF and Sale of Products. EBITDA was higher by 14.9% at ₹1,848 million, which represents a 32.3% margin. PBT stood at ₹981 million, higher by 42.5% with a margin of 17.1% and PAT stood at ₹635 million, 30.0% higher with a margin of 11.1%.

Let's see how our business has performed excluding the impact of VDSPL. EBITDA excluding VDSPL was higher by 19.0% Y-o-Y at ₹1,918 million, representing a 33.8% margin. PBT excluding VDSPL was higher by 56.0% at ₹1,082 million with a margin of 19.1% and PAT excluding VDSPL grew 49.1% to ₹736 million representing a 13% margin. This PAT includes Tax expense of ₹33 million which is tax paid by Company's subsidiaries on the Inter-Company divided income they received from UFO's other subsidiary. As such the normal PAT attributed to the Group's business operations excluding VDSPL should have been ₹769 million.

On the Theatrical business side, E Cinema VPF revenue grew 10.7% Y-o-Y. Operationally, the number of E Cinema screens marginally declined which is normal churn. We expect the number of screens to go up and down in the next couple of quarters and this number will stabilize in the long run as mentioned in previous calls.

Advertisement revenues stood at ₹1,578 million, an increase of 35.3% Y-o-Y. Corporate Advertisement revenues grew 37% compared 29% growth from Government Advertisements during the year. The volume of in-cinema advertising consumption on UFO's network has grown steadily. Advertisement minutes sold per screen per show during the year stood at 4.15 minutes compared to 3.36 minutes last year.

UFO's financial position continues to strengthen, the Company's Net Debt as on March 31, 2016 stood at ₹24 million compared to ₹507 million last year and as we speak, the Company is now in Net Cash.

The Capex during the year stood at ₹695 million, which includes ₹178 million towards the expansion of Caravan Talkies. Accordingly, the Capex toward the normal business was ₹517 million which is in line with our annual guidance.

We continued to generate strong cash flows during the year, allowing us to return value to our shareholders through dividends. The Board recommended a Final Dividend of 30%, as a result the cumulative Dividend declared for the year aggregates to 80% which translates to over 34% of the Company's FY16 Consolidated PAT.

Lastly, as communicated in our previous call, I am happy to inform that we have settled the ongoing dispute in relation to patent issue by entering into definitive agreement with Real Image. This settlement does not have a material impact on our financials.

With that, I open the floor to take your questions.

Moderator: The first question is from the line of Pritesh Chheda from Lucky Investment Managers.

Pritesh Chheda: Out of total Capex of ₹69.5 crore, ₹18 crore was towards Caravan Talkies, where has the remaining ₹51 crore been spent? Why was the depreciation flat in FY16?

Ashish Malushte: Capex has two components i.e. spent on VDSPL's Caravan Talkies and the remaining ₹51 crore was towards the upgradation of our theatrical network which was in line with our FY16 Capex guidance of ₹50 crore to ₹60 crore. And we have been guiding the market that we will be incurring similar amount of Capex annually towards the replacement and maintenance of our network as the number of theaters is stabilizing.

While there is an addition of ₹50 crore this year, the gross block of the Company has been built from 2005. Some element of this gross block has gone out and as a result the depreciation for FY16 is stable.

Pritesh Chheda: Will the upgradation of theatrical Capex continue at the same pace in the future?

Kapil Agarwal: Yes, because there are equipment which we have been buying since 2005, and these equipment has a limited life. We have been proactively upgrading the quality of these equipment. The quality of the equipment was very different 10 – 11 years back. Now more robust, stable and steady equipment are available. We are doing a planned upgradation of the equipment over the next 5 - 7 years and that is exactly where we expect to incur the Capex of ₹50 to 60 crore which is very different from the growth Capex incurred two years back.

Pritesh Chheda: Why have the debtor days increased in FY16?

Kapil Agarwal: The last quarter has seen 55% growth in Advertisement Revenues. A lot of debtors have been booked in the last quarter. The normal payment cycle for advertisement is 90 days to 120 days, there is nothing abnormal. A lot of these debtors have been realized in the month of April.

Pritesh Chheda: Can you quantify the PAT impact for FY17 and FY18 due to sunset and do we have to consider lease rental impact as well?

Ashish Malushte: At this stage we have guided on the EBITDA impact. We can further dig up to the PBT level. We would have a PBT impact in the range of ₹42 to ₹46 crore by the peak of the sunset i.e. by FY20, this impact after factoring in reduction in operating expenses would be about ₹37 to ₹41 crore i.e. from the level of what we saw in FY15. This means from FY15 to FY20 we are likely to lose a PBT of ₹37 to ₹41 crore of which close to ₹3 crore of PBT has already been lost in FY16. The remaining impact from FY17 to FY20 is likely to be in the range of ₹34 crore to ₹38 crore after factoring in reduction in operating expenses.

Pritesh Chheda: Can you break it for FY17 and FY18?

Ashish Malushte: We have a cumulative PBT impact of approximately ₹6 crore to ₹8 crore up to FY17. The cumulative impact for FY18 including this ₹6 to ₹8 crore is going to be in the range of ₹18 crore to ₹21 crore.

Pritesh Chheda: Would the impact in FY18 be ₹7 crore?

Ashish Malushte: No, the incremental impact would be approximately ₹13 to ₹14 crore in FY18. .

Moderator: The next question is from the line of Mr. Prasad Padala from Investec.

Prasad Padala: Contribution from Government Advertisement saw a jump from 63% to 67%, is it because of the rate increase or volume?

Kapil Agarwal: Contribution from Government Advertisement in FY16 has grown by 29% and this is entirely because of volume as Government prices for advertisement is same since 2010. 29% is a very healthy growth which is in line with the overall growth guidance. Corporate Advertisements grew by 37% during FY16.

Prasad Padala: Is this driven by volumes?

Kapil Agarwal: Government growth has come 100% from volume as there is zero impact of the pricing.

Prasad Padala: Are there any extraordinary gain from that front, like elections?

Kapil Agarwal: There were no elections. The current Government is very active on various fronts on the common people programs like the "Jan-Dhan Yojana", "Swachh Bharat Abhiyan" and more such programs are coming up and our medium is appropriate for reaching the people at large all over the country because we have presence in more than 1,900 locations having the deepest penetration. Our network is in more than 1,400 cities and towns while multiplexes, maximum 50 cities and towns. We are the most appropriate medium for the common people program of the Government and thus spending by the Government is going up.

Prasad Padala: Why have the advertisement screens declined by 2% Y-o-Y?

Kapil Agarwal: There is no decrease. Because of digitization, most of the screens are getting content and thus they are making money. In this process, a lot of screens are now being renovated; they convert into 2 – 3 screens complex from 700 – 1000 seater single screens. This churn of 50 – 60 screens will keep happening all the time which does not have a significant impact on us. Next year you might see a higher number as we are now signing with smaller chains of multiplexes for the ad contract. Thus there will be no significant change in the number of advertising screens and will hover between 3,700 and 3,800.

Prasad Padala: Can you briefly discuss the competitive intensity in the market?

Kapil Agarwal: At the high level, almost 90% of the market is between UFO and Real Image. There are other fringe players for the other 10%.What we have seen in last 10 years is that, whenever business starts doing well few people start disturbing the market and they start throwing everything to the market free of cost. They would not charge any rental from the exhibitors, or they will charge substantially reduced virtual print fee. These disturbances keep happening all the time. We keep losing 50 – 60 screens here, but they go to them only for a short run, then they realize that they are not able to service their screens and ultimately come back to us. Unless your business model is viable, you will not be able to service the screens. Thus these 50 - 60 screens plus-minus will keep happening that we have seen Y-o-Y but there is no significant impact on our overall business.

Prasad Padala: Caravan Talkies' losses have slightly gone up. What is the future expectation and how do you see the business panning out?

Kapil Agarwal: When UFO's business was growing during 2007-09, we faced many challenges in the market in terms of getting the advertising revenue or getting the content. Now Caravan Talkies being a new business is going through a very similar cycle. But, that cycle is not going to be long because we were new at that time and now we are the market leader. It is just that we grew very rapidly, we started the year with 24 vans and took it to 114 vans within 4 – 5 months back and then we have stopped investing in that business. Out of 114 vans 91 are operational, across 91 districts over 6 states. There will be cash burn because they will have daily expenses across these routes. All the routes were not profitable, so we are now stabilizing it by re-routing the vans, examining all the routes and changing the system of how we announce to get people The advertisers are now getting convinced. While we were expecting this business to stabilize faster, it did not happen. In H2FY17 this business is expected to stabilize and from next year onwards it should start giving us good bottom-line. Q1FY17 is gone and next quarter is monsoon season so there will be only negative contribution from this business as there will be zero revenue during the monsoon season. This business will restart only in H2FY17. From October to March, it is expected to stabilize and next year onwards it should become a money making business.

Moderator: The next question is from the line of Varun Joshi from Religare.

Varun Joshi: Can you just throw some more light on UFO Framez, the hyperlocal initiatives and how is that panning out and can you give any guidance for FY17?

Kapil Agarwal: Guidance for FY17, we expect to achieve 30% advertisement growth in FY17.

Framez is nothing but a means of achieving higher utilization and getting a higher effective spot rate of advertising. We have divided our ~3,500 advertising screens, scattered across 1,900 locations and 1,400 cities and towns into more than 600 clusters. One direct sales associate (DSA) is being appointed for each cluster. We have already started the DSA program. This business was launched in the month of April i.e. last month. Our idea was to launch this Framez DSA program towards the end of this year and have effective returns in the subsequent year but we preponed it to Q4FY16. It is a completely technology driven business. We have end-to-end technology for this business, and now any local DSA should be able to upload the advertisements on the screen directly from his computer. It is automated to that extent. We also realize that this business cannot run if there is an intervention from our side. So we converted this into a prepaid business. This is for hyperlocal advertising like the local shop, the local restaurants, local boutiques and it can only be handled hyper locally that is why these DSAs are appointed. We are in the process of appointing DSAs and around 180 – 190 DSAs have already been appointed. That means these DSAs have already deposited the money with us. Now when a DSA is appointed, it is not just appointment, there is a very rigorous training program for these DSAs, also they are being given very beautifully designed sales kits as they will be representing UFO. They will go from door to door in their region and sell advertising. We are taking personal interviews all over the country at our 24 regional offices. Those offices have been involved in identifying these DSAs. The most beautiful part is that we did not spend a penny in acquiring these DSAs. We just ran a 30 seconds slide with a voice over in all our screens and within a week against 600 requirements we got some 10,000 to 12,000 applications. That showed the effectiveness of our medium as what we can achieve. These DSAs will be selling a 10 - 20 seconds spots which cumulatively will add 1.5 – 2 minutes to our whole advertising once this program stabilizes in next couple of years. I would not give you a guidance on this, it being a new program. It will take its own time but it has started to generate very moderate revenues in the current quarter. By end of this year, this business should also stabilize and start kicking in revenues by next year.

Varun Joshi: Are you charging the DSA ₹50,000 per person per month, what is the number that you guys work with on the prepaid side?

Kapil Agarwal: No, it is not ₹50,000 per month. He deposits ₹50,000, then goes and sells the advertisements. Whatever advertising on the prefixed rates he sells, that money gets deducted from his deposit and once this money ends he has to refill his deposits by whatever sum he wants like ₹5,000 or ₹10,000. But we have fixed very rigorous targets that if he doesn't do as much of business say in one quarter then we terminate the DSAship because we also want to keep him on hook as we are giving him exclusivity in that region.

Moderator: The next question is from the line of Sanjay Parekh from Reliance Mutual Fund.

Sanjay Parekh: Can we compensate the PBT loss of ₹6 – 8 crore in FY17 and ₹12 – 13 crore in FY18 by the Caravan profits in the next two years or it will not be able to compensate entirely?

Kapil Agarwal: That is exactly what the plan is, because we were very conscious from day one that this sunset is going to happen, thus it is planned. That is why we are pushing new businesses and Caravan Talkies was one of the most important initiatives which will compensate this loss. We believe it will compensate; however, Caravan Talkies is running a year behind. We were expecting that it to be positive by now but it is not and that is the reason UFO Framez program was advanced and put in pipeline in Q4FY16 so that it will start giving us some revenues this year and can party compensate for PBT losses. Overall we are comfortable to say that we should be able to make up these losses though Caravan and enhanced advertising revenues.

Sanjay Parekh: In 2015 the net working capital excluding cash was negative ₹50 crore and this year it is almost flat at zero. Is this net working capital intensity almost flat and can we say that the net working capital will remain flat in the future?

Ashish Malushte: Yes, more or less that will be the situation.

Sanjay Parekh: Assuming your cash profit with growth outlook being good and Capex of ₹50 crore, the net cash post Capex could be ₹100 to ₹120 crore. Now, you have done a very good job increasing the payout but can we also discuss internally subject to the Boards' approval for further increasing the payout?

Sanjay Gaikwad: We do not like to keep cash in the Company if it is of no good use from the growth perspective. We will be evaluating all our cash needs and we will get back to you about what program we have in mind.

Kapil Agarwal: To sum-up we have given the guidance of at least 25% PAT to be distributed and we have distributed close to 35% of the Company's Consolidated PAT in FY16. And if we include the divided distribution tax it goes up to 40% of the PAT.

Moderator: The next question is from the line of Arjun Khanna from Kotak Mahindra Asset Management.

Arjun Khanna: Will DSAs have to upload a censor certificate along with the Ad?

Kapil Agarwal: Uploading of ad is direct except that there is a censoring of the content in between by our regional offices. There are 24 regional offices where we carry out one level of check before the advertisement slide is uploaded. Accordingly, the slide lands in the inbox of our Regional Manager who has to approve it. The Regional Mangers have been trained and have been given comprehensive guidance on what content to be uploaded and what content to be rejected. So, any explicit content will be rejected and once they give the approval then it will again be uploaded and the money will be deducted from the DSA's account. There is one only check in between to check the content.

Arjun Khanna: What format would they be uploading? Slide conversion costs roughly ₹4,000 to ₹5,000 for JPEG 2000 format and the costs for movies is much higher in terms of conversion.

Sanjay Gaikwad: We give them flexibility to upload any picture format for slide and MP3 or Wave file for audio. And finally when it comes on our cloud server, it gets processed into the format which our server understands. For the DCI systems where JPEG 2000 is required, we have developed a download box or ad blusters at such locations which converts it to JPEG 2000 at the theater end level.

Kapil Agarwal: Only slides are allowed under this business and no audio visuals are allowed but a voiceover over the slide is permitted.

Arjun Khanna: Do we charge for conversions?

Kapil Agarwal: That is a part of our charges, because we are doing that for our own server. We have given flexibility to the market to upload in any format they want. These are not the tech savvy people all over the country and we are going to the remotest place. So, we have developed tools for various formats and those tools automatically convert it at the server level.

Arjun Khanna: You were earlier referring to VPF charges by competition being slightly lower; does that mean we would not be taking hikes going forward?

Kapil Agarwal: We started at a very low VPF rate at the start of the business. From beginning till 2011-12 we have been taking a lot of hikes. We took the price from ₹100 to ₹350 - ₹400. We took one hike in 2012, then from 2012 to 2015 we did not take any hike and then in 2015 we took another hike. But these hikes have nothing to do with our competition because we have a network of ~5,000 screens and those competitors have a network 200 - 300 screens, and they have very low grade screens. That is not what gives us competition, a big distributor or a big producer will not ask for that price. They cannot cater to this market. The way we decide our VPF charges is not threatened by competition but it is more strategically decided by us because we have to strike a fine balance between the VPF that we charge from the distributor and the footfalls. If we start charging too much of VPF then he will stop giving the film to lower category of theaters, that will drop our footfalls and our advertising revenue will be compromised. When we hike the VPF rates, we ensure that the footfalls do not go down from the theaters and they do not stop getting the films. So it is guided by this than the competition, which is not significant for us.

Arjun Khanna: Can you give any timelines for increasing the VPF rates or currently there is no such plan?

Kapil Agarwal: Currently, we do not have any plan, because we have taken the last hike in 2015 itself. We strategically take the call from time to time because our focus is mainly advertising and we do not want that business to be compromised as an increase in VPF brings very small revenue but lot of negativity in the market. While enhancement of the ad revenue is far greater for us.

Arjun Khanna: Is 30% hike in advertising for the year ahead, volume driven i.e. 4 mins could move up or do we factor in some element of pricing of Government advertising considering DAVP has not revised their rates?

Kapil Agarwal: The forecast is purely volumes right now, because we can correct the prices later. Even if the Government enhances prices, it does not mean that Government revenue will increase by 30% overnight, because the budgets are defined already in the beginning of the year. Higher rates in the Government Advertisements might mean lower minutes utilization but not compromising the revenue.

Arjun Khanna: Will Government budgets for advertising on cinema going up will have a greater impact on us rather than rates for Government advertising going up given that we have so much inventory?

Kapil Agarwal: Yes, for the current year. But I am not as sure whether there will be a rate hike in the current year because we have been campaigning with the Government for last three years and it has not happened yet. If the rate increases it will bring higher revenues in the long run.

Ashish Malushte: The focus of the Company has been to ensure that Corporate Advertisement as a vertical starts contributing significantly, and that was a strategy which we laid down three years ago. Corporate was contributing only 18% in FY12. In FY16, Corporates contributed 48%. Going forward our focus clearly is now on the Corporate side and that is clear from the numbers.

Moderator: The next question is from the line of Yash Jhaveri from Alder Capital.

Yash Jhaveri: Any comments on Nova Cinema and are we going to incur any Capex here in FY17?

Sanjay Gaikwad: All are aware that digitization in this country is over, the new screen addition is not happening the way it used to when we were in digitization mode. We need to recreate this growth driver as the screen density in our country is very low especially in a non-premium demographic market which is basically in Tier-II and Tier-III cities where we have major presence and which is currently dominated by single screens. Now in this location, the screen density is really low and that is where we will have to create a program or create an initiative which is primarily a franchise driven initiative where we create standardization and which can create a one stop solution for the franchise. To establish that concept in the initial period, we may have to setup pilots at 10 – 15 locations and for which we have to do Capex. Post this pilots, the business model of Nova does not require any investment. All the investment would be done by the franchises.

Yash Jhaveri: Can you quantify the Capex for these 10 or 15 pilots?

Sanjay Gaikwad: ₹12 to ₹15 crore.

Yash Jhaveri: Are you going to increase the number of vans to 300 in FY17 for Caravan Talkies?

Kapil Agarwal: No. We have reached to 114 vans four months back and we have stopped the Capex there. First, we intend to stabilize these vans, get profitable routes, deploy them profitably on the correct routes, stabilize this business and then only do further Capex. I cannot give guidance when that will happen, because it looks unlikely to have any further Capex during the current year. But if we stabilize the business by December and if it starts becoming profitable by that time then we will take a strategic call to invest further. But till it doesn't stabilize we are not doing any further Capex.

Moderator: The next question is from the line of Aditya Mathur from Citigroup.

Aditya Mathur: Ad revenue sharing to exhibitors have come down for FY16, was there an impact of minimum guarantee that is given to the screens, can we see some leverage on this line item? And on your agreement with Real Image, while you guys mentioned that the financial impact is small, could you throw some more color in terms of what the agreement is and how does it work?

Kapil Agarwal: It is a co-existence agreement between UFO and Real Image where certain payments are going to be made. It is bound by confidentiality so I cannot disclose the numbers on the call. However, all I can say is, it is into Lakhs and not even a Crore, as simple as that we are not paying ₹3 or ₹5 crore or the Company's fortune is being shifted to Real Image, it is not even a Crore.

Ashish Malushte: On the question of sharing being done with the theaters, which is a contractual sharing of the advertisement revenue and we have been pointing out that there is an operating leverage opportunity here. This year the sharing on an annual basis has come down to 30.66% from previous year's numbers of 33.84%, so about 318 basis points improvement in FY16 itself. And before that year, it was in the range of 37% to 38%. There has been a steady increase in this benefit which is in the form of a reduction in the percentage of sharing and that would continue to happen as our advertisement revenue keeps going up. We are estimating that when we reach around ₹280 to ₹300 crore level, this will plateau at around 26 – 27% level.

Moderator: The next question is from the line of Urmil Shah from IDBI Capital.

Urmil Shah: From a 3 - 5 year horizon, what is the kind of mix should we expect with regards to ad revenue amongst the Corporate, Government and Framez?

Kapil Agarwal: I would rather call it Corporate and Government instead of calling it Corporate, Government and Framez, because Framez is part of the overall Corporate strategy. Our focus is majorly on the enterprise sale which is Corporate advertising. Corporate includes large Corporate, retail, state level players, local players, trailer business and Framez. There are multiple verticals within that for which there are different teams to handle the same. Overall, Corporate has grown from ₹7 crore, 4 years back to ₹72 crore this year which means there is an improvement in contribution from 18% to 48%. This will keep growing and probably should stabilize in the long-run at two-third of the overall revenue.

Sanjay Gaikwad: We are very bullish on UFO Framez. In 4 - 5 years of horizon, one-third would be Government, one-third would be Corporate and one-third would be Framez which is hyperlocal advertising of the total ad revenue.

Kapil Agarwal: As a result, two-third will be Corporate.

Urmil Shah: Does the advertisement revenue shared with the theaters change in case of revenue from Framez?

Ashish Maluste: It does not change.

Kapil Agarwal: Yes, it is part of the overall ad revenue, as far as the theater owner is concerned, for him advertisement from UFO is advertisement without looking at the segment from which it is coming.

Urmil Shah: We have been communicating that eventually the advertisement revenue share will be higher than the lease income that the theater owners pay, when should we expect that to happen?

Ashish Maluste: Advertisement revenue per screen, on an annual basis has moved from ₹3.16 lakh to ₹4.1 lakh for FY16. Here at this stage, about 25% is in excess of ₹1 lakh, if I take this as a global average against our rental average of ₹12,500 per month, this is currently giving back close to 70% of the rental that we are charging. Another 40% growth from the current level of advertisement revenue should see us in a situation where we will start giving more revenue back to the theater. In fact, while I mention this, there are many theaters who have already crossed that limit because their contribution is more in advertisement revenue or because their rental is less than average of ₹12,500.

Moderator: The next question is from the line of Rajesh Kothari from AlfAccurate Advisors.

Rajesh Kothari: When you are giving guidance of 29% to 30% ad growth over next two years, how do you see overall cost and margins panning out?

Kapil Agarwal: There are three costs involved in acquiring advertisement; one is revenue share with the theater, which should ultimately stabilize in the range of 26% to 27%. Then there is cost of acquisition which is agency commission that we pay and it is a variable cost in the range of around 8%. 26% plus 8%, will add up to 34% - 35%. Then there is a direct manpower cost and the incentives to the ad sales team, which will be around 7% to 8%. Broadly, 55% to 60% of all the new ad revenue will be going to the bottom-line, straight EBITDA and PBT contribution.

Rajesh Kothari: Where do we stand currently in terms of theater revenue share?

Kapil Agarwal: Theater revenue share is 30.6% currently. The acquisition cost is around 8% and the manpower cost and incentives is around 10%, which is around 49%. The contribution is 51% and going forward as our revenue enhances, it should go close to 60%, from 51%. That gives you tremendous operating leverage.

Rajesh Kothari: Why you are expecting the theater share to reduce from 30.1% to 26% - 27%?

Sanjay Gaikwad: The current 30.1% is because we have given certain minimum guarantees to theaters for advertisement revenue. The contractual arrangement with the theater is 25% in the non-south market and 10% in the south market. The weighted average is around 20% - 22% which we feel will settle to about 26% because of the MG effect. As your advertisement revenue starts growing, your MG related increase in ad revenue share will keep coming down.

Moderator: The next question is from the line of Bijal Shah from India Infoline.

Bijal Shah: What explains this sharp variability in growth of advertising income because your advertising income grew by 88% in Q1FY16, then it grew by 8%, then 15% and now it is 55%?

Kapil Agarwal: Unlike any other business, our business is very unique and we have been guiding the market quarter-on-quarter to look at us on an annual bases. Our growth for Q1FY16 was around 88% and Q3 15% i.e, our growth in 9MFY16 was 28%, so we had to grow 55% to be able to achieve our guidance of 35%. All investors during the Q3 were very worried that how we would achieve 55%. During Q3FY16 Government revenue showed a flat growth of 0.2% and the Corporate revenue grew by 25% giving us an average of 15%. I have been guiding the market that, the pattern of advertising of advertisers keeps varying from quarter-to-quarter, for example, the Government ad revenue in Q1 is very low and Q4 is very high because they have to finish all their budgets. On the contrary Q3 & Q4 are the heaviest sector for Corporate sector, it being the festive season. From Eid to Diwali to Christmas, maximum number of Corporate advertisers wants to push their products. But Corporate sector in the last quarter is not that high. For Q3FY16, the growth for Government advertising was 0.2%, while in Q4 the growth was 65%, it keeps varying. The advertising patterns also get affected by the external events, for example if there is an IPL or World Cup event, then all the money goes into cricket. Therefore we have been painfully giving the guidance to the market which I hope the market will appreciate now to look at our advertising business as an annual business and not on a quarterly basis. Even this 30% for future that we are talking about is to be looked annually and not quarterly. Advertising also gets affected by the kind of films which releases in each quarter. Any blockbuster release in a quarter will see more advertising by Corporates and vise-versa. All these external factors are not in our control. But as we have seen for five years, we have grown 44% on an average.

Bijal Shah: Will the volatile growth of advertising income change which is swinging from one end to another end on a quarter-to-quarter basis once the base of your advertising income grows?

Kapil Agarwal: When you go to a very large Corporate advertiser who is going to spend a ₹5 crore on a campaign, he thinks that he knows which movie will work well, so he wants to do a Shah Rukh Khan movie or Amir Khan movie, thus they tend to capture large movies. That is where the pattern differs. When you are going for the hyper local advertising, there are two initiatives that we take. One kind of Framez which is not going to be too much affected by the film, so there will be reduction in volatility, although it will not go away. Second, we are also now tending to give concession to large corporates but sign long-term contracts like a six-month contract or a one year contract at a lower price. Then week-on-week our advertising revenue will be underwritten irrespective of the large movies coming or not. Volatility will go down but it would not get eliminated.

Bijal Shah: I understand that VPF is not our focus area but it seems that for advertising revenue we need to think of footfall and if we increase VPF then some of the screens at the bottom end may go away. Is there any way in which our VPF revenue can be linked to the theater's collection rather than being absolutely same for localities, probably for Mumbai as well as for very small towns?

Kapil Agarwal: We have thought of all of this and we have stabilized our model that instead of doing that, having a per show charge is best for us and that is primarily because of the unreliability of the box office collection which is declared by the cinema owners. Those numbers are not reliable. The moment you link their revenue, and if there is an under-declaration by n-number of theaters, your revenue will also get compromised. That is why we have decided not to link our shares, however we are absolutely open, if tomorrow, we see that there is reliability in the box office numbers and the collection numbers are truthfully declared and the credibility is there, we will be happy to link .

Bijal Shah: Can we have a different rate for Bombay and say one small town in UP?

Kapil Agarwal: We have created that distinction from the perspective of earning potential of the various kinds of theaters. There are screens which are called DCI screens where PVR, Inox, and all major multiplex chains use the Hollywood technology where fixed rates are charged per location. These are top screens where our revenue is highest. We have given the average revenue per screen for D-Cinema and average revenue per screen E-Cinema and that revenue is widely different. D-Cinema revenue is almost double. We have already achieved that by way of creating that distinction. In smaller locations there are two kinds of movie goers, regional and another is the mainstream movie goers. Theaters are categorized like who play only Bhojpuri or Bengali movies. For regional language movies, we have a different rate card which is lower than mainstream movies, so they automatically get that concession. From the mainstream theaters, even at smaller places as they make a lot of money from mainstream movies our rate card is different. For the south market, there is a fourth rate card. There are multiple rate cards which actually take this sensitivity into accounts and which has grown and developed over a period of last 10 years.

Moderator: The next question from the line of Vikas Mantri from ICICI Securities.

Vikas Mantri: Given that the model is well established and the single screens cannot do away without you or Real Image, why can't they start investing in their equipment because that will also keep up seeing some technological advancement and therefore we become more Capex light. Any thoughts on that strategy?

Kapil Agarwal: They are welcome to invest in their own Capex and people have attempted to do so. Just imagine that I buy 1,000 projectors from a manufacturer and a theater himself has to buy one projector at three times the cost.

Vikas Mantri: Can you not procure and sell it to them? So, we do not have any asset on our books and we sell it to them at cost, then the advantage will also be there?

Kapil Agarwal: We are happy keeping the cost on our books because the dependence of the theater is on us. The moment he moves away from us he has to do that Capex or somebody else has to do that Capex. Investing that money also ensures the quality of screening in the cinema is maintained, because we maintain that equipment at a very high level as we own the equipment and we replace it when the life of the equipment ends which the theater owners might not do. There are lot of variables associated to it. Today, we are a debt free company despite doing all the Capex. This gives us the strength to continue our association with the exhibitors. Whatever investment has to go is already gone, and now it is just ₹50 to ₹60 crore replacement Capex annually, which is for our own equipment.

Moderator: Thank you. Ladies and Gentlemen, that was the last question. I would now like to hand the conference over to Mr. Ankur Periwal for his closing comments.

Ankur Periwal: I would like to thank the management of UFO Movies and all the participants for their participation in the call. Thank you and look forward to host you next time. Thank you.

Moderator: Thank you. Ladies and Gentlemen, on behalf of Axis Capital that concludes this conference. Thank you for joining us and you may now disconnect your lines.