# UFO Moviez India Limited Q2&H1FY2016 Earnings Conference Call

November 10, 2015

**ANALYST:** **MR. SUVEER CHAINANI - HEAD OF EQUITY SALES - CITIGROUP GLOBAL MARKETS INDIA PRIVATE LIMITED**

**MANAGEMENT:** **MR. SANJAY GAIKWAD - MANAGING DIRECTOR - UFO MOVIEZ INDIA LIMITED**

**MR. KAPIL AGARWAL - JOINT MANAGING DIRECTOR - UFO MOVIEZ INDIA LIMITED**

**MR. ASHISH MALUSHTE – CHIEF FINANCIAL OFFICER – UFO MOVIEZ INDIA LIMITED**

**Moderator**: Good day ladies and gentlemen and welcome to the UFO Moviez India Limited Q2&H1 FY2016 Earnings conference call, hosted by Citi. As a reminder all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing "*" and then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Suveer Chainani, Head of Equity Sales, Citi. Thank you and over to you Sir!

**Suveer Chainani**: Thank you Malika. Good day ladies and gentlemen. On behalf of Citi I welcome you all to the UFO Moviez Q2&H1FY2016 earnings call. The Company is represented by Mr. Sanjay Gaikwad, Managing Director, Mr. Kapil Agarwal, Joint Managing Director, and Mr. Ashish Malushte, CFO.

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 Sir!

**Sanjay Gaikwad:** Thanks Suveer and a warm welcome to everyone for joining us on our Q2&H1FY16 earnings conference call. Before I begin a very Happy Diwali to all of you!! Without taking much time, I will quickly run through some of the key numbers and business highlights and then open the floor for discussion.

In Q2, total consolidated revenue increased by 17.7% to ₹1,497 million compared to ₹1,272 million in the corresponding quarter last year. We had a very balanced growth for our service business and robust growth in our product business during the quarter. EBITDA increased by 11.8% to ₹463 million as compared to ₹414 million last year. EBITDA margin for the quarter was 30.9% compared to 32.5% last year. Margins contracted by 163 bps during the quarter primarily due to higher operating direct costs. These costs include Virtual Print Fee (VPF) shared with multiplexes and pre-operating costs towards Caravan Talkies which we highlighted last quarter as well. PBT for the quarter stood at ₹239 million, higher by 26.6% year on year and PAT stood at ₹165 million, 26.5% higher over Q2FY15.

Looking at the first half of the current fiscal, we saw strong financial performance with 20.2% growth in consolidated revenues to ₹2,802 million. The primary factor driving this growth was robust volumes of In Cinema Advertising, higher E Cinema VPF and Sale of Products. EBITDA stood at ₹868 million, an increase of 12.4% year on year. EBITDA margin for H1FY16 was 31.0% compared to 33.2% last year. PBT stood at ₹421 million, a growth of 33.5% and PAT reached ₹297 million, an increase of 41.4% year-on-year.

Let me now turn to the performance of In Cinema Advertising. Advertisement revenues appear to have had a weak quarter on a high base. In reality, Advertisement revenues in Q1FY16 and Q2FY15 were enlarged as a result of revenue spillover. In Q1FY15, Government Advertisement was impacted by blackout due to general elections, as a result revenues spilled over to Q2FY15 resulting in a higher base for the current quarter. Similarly, Corporate Advertisements in Q4FY15 were impacted by the ICC World Cup resulting in spillover into Q1FY16. As a result, our Q2FY16 Advertisement revenues are strictly not comparable. If we look at it on a half yearly basis. Advertisement revenues in H1FY16 totaled ₹707 million, an increase of 37.8% year on year which is in line with our annual expectation of 40% to 50% growth. We are very confident of achieving this growth given that Q3 and Q4 are normally stronger than Q1 and Q2 due to more blockbuster releases during the festival season. Advertising Revenues contributed 25% of revenue from operations in H1FY16 compared to 22% in H1FY15. The total number of advertisement minutes sold per screen per show was 3.83 during H1FY16 compared to 2.92 minutes in the same period last year.

E Cinema VPF grew by 12.4% during H1FY16 compared to H1FY15. This growth is attributable to rate hiked on Hindi movies with effect from April 1, 2015 and Regional movies with effect from September 1, 2015.

I would like to highlight how we have performed on some of our key parameters during the period.

Firstly, on Capital Intensity, if we look at our Theatrical Business, the intensity of initial capex required toward screen digitization is over and will remain low with incremental Capex toward replacement. Hence the depreciation continued to remain stable. This has resulted in higher cash generation and significant reduction in net debt to ₹216 million as on September 30, 2015 from ₹507 million as on March 31, 2015. Consequently, the interest cost has reduced driving higher profitability.

On Capital Efficiency, strong growth in revenues driven by Advertisements and E Cinema VPF has resulted in better operating leverage. The Company's RoCE has thus improved to 15.21% as on September 30, 2015 from 14.28% as on March 31, 2015.

I would also like to highlight that one of our key philosophies is to strategically Allocate Capital only towards synergistic businesses with low content risk. Caravan is one such business with low capital intensity and we are very optimistic about its future. Caravan Talkies remained non-operational during the quarter due to monsoon. We continued to grow the number of vans during this period, totaling 69 vans as on September 30, 2015 up from 24 vans as on March 31, 2015. This number is expected to double by the end of the current fiscal. While Caravan Talkies is currently reporting negative EBITDA due to pre-operating expenses, it is expected to achieve EBITDA breakeven within six to nine months.

With that, I now conclude my opening remarks on the quarter and half years performance and open the floor for questions.

**Moderator:** The first question is from the line of Amit Kumar from Investec Capital.

**Amit Kumar:** Why is there a jump in sale of products in H1FY16 and what is the sustainable level of growth?

**Kapil Agarwal:** Initially we were investing in equipment when we were in the VPF phase, particularly in international markets where we used to do investments and get VPF from the Hollywood Studios in lieu of that investment, which was our service revenue model. The VPF period is over in Middle East and Israel, which means Hollywood Studios will not be giving any VPF for new installations. Since there is a change in the business model, we are not investing in those equipment anymore and we are asking the theatres in these regions to buy equipment from us around which we make a good profit margin. Similarly even in India, we have moved away from making investments in equipment in multiplex chains. We have moved to a model where we ask them to invest in their own equipment. On an annual basis and not on a quarterly basis, we believe that it is a sustainable model because India is seeing 4% to 5% growth in number of screens and there is screen growth internationally as well. This is a sustainable business and we have seen this growth in the past. The second component is sale of the lamps. Since the cumulative number of the projectors sold by us is increasing quarter-on-quarter and year-on-year, the cumulative number of lamps is also increasing, which is contributing to this higher sales and that is clearly sustainable. As I said earlier, it is not a quarterly business, it is going to happen annually because the number of screens opening in a quarter is not in our control but overall on an annual basis that growth is happening.

**Amit Kumar:** What is the breakup in H1FY16 for sales of equipment and lamps?

**Ashish Malushte**: Domestic in H1FY16 contributed ~30% of the revenue and of this 30%, 82% i.e. ~24% of our total revenue comes from lamp sale which is perpetual in nature. International predominantly is from equipment sale and lamps sale is relatively less, although sale of lamps continues to be a perpetual one.

**Amit Kumar:** International D Cinema VPF has seen a jump in Q2FY16. How is the trend? And, what are the key drivers on a quarterly or annual basis?

**Kapil Agarwal:** It is a function of the number of movies released which varies from quarter-to-quarter. This is not a quarterly business because the number of movies Hollywood Studies release in a particular quarter is not in our control. We know that (n) number of movies are released on an annual basis that get spread over the year but quarter-on-quarter that number keeps varying. Last quarter, International releases were higher so you see higher D Cinema VPF. In India the number of movies in Q3 will be higher and better. So you may see a jump in India this quarter. Thus it keeps changing quarter-on-quarter. And therefore it has to be really looked at from the annual perspective.

**Amit Kumar:** Which line item represents operating cost in Caravan Talkies? And what was the EBITDA impact and the margin impact this quarter?

**Ashish Malushte**: You are looking at the consolidated numbers. There will be no separate line item for Caravan's expenses. In terms of the negative impact of Caravan pre-operating expenses, this quarter we did not have any Caravan revenues because of monsoon as disclosed during Q1's conference call. In Q2, ₹0.96 Crore would be the negative impact and it has translated to close to 64bps in terms of reduction in EBITDA margin.

**Amit Kumar:** In Q2 as well as in Q1 other direct cost had jumped up substantially this year versus last year, is majority of the Opex of Caravan getting captured in the other direct cost?

**Ashish Malushte**: This would be primarily with respect to Caravan. It will be split in two parts. One will be in manpower cost and one will be in the other direct cost i.e., the operating direct cost.

**Moderator**: The next question is from the line of Amit Mehta from Sunidhi Securities.

**Amit Mehta**: In Q2FY16 and H1FY16, how many new screens have been added and how many screens have gone out of the UFO network?

**Ashish Malushte**: If you see the presentation that has been circulated and put up on the website of the Company, slide two will give you a snapshot of the number of screens. On the left hand side you have the digital cinema network screens and on the right hand side you have the Advertisement network screen. The digital cinema network screens stands at 4,940 September 30, 2015 and there has been a reduction of 25 screens as compared to June 30, 2015 and 92 screens as compared to March 31, 2015. That has been on the absolute number and a similar reduction has been there in the Advertisement screens.

**Sanjay Gaikwad** Initially there was high de-growth of single screen before digitization started. Because of the early availability of the content, de-growth completely stopped and we continue to monitor the risk associated with the screen de-growth. And the way we monitor this is by seeing how many screens are doing relatively low revenue from our distributors because that is the yardstick for risk estimation. From that perspective we have seen that, 136 screens had VPF revenue less than ₹50,000 in FY2014-15. That number stood at 129 in H1FY16. These are the screens which are at the risk of closure in the coming year. However there are a lot of screens which are under renovations and which are going under the temporary closure. They are primarily on account of renovation. In H1, we have seen that 100 to 120 screens went under this category, they are either going for license renewal or going for small or big renovations. And we have also seen ~78 screens came back after renovations. In the long run what will happen is, although the de-growth has stopped, temporarily there will be some screens which will go for the renovation and there would be a risk of permanent closure to 130-150 screens, because less than ₹50,000 VPF means, those screens does not have potential, to generate the revenue from the content and obviously getting contents to those screens will become difficult. However, some of the screens which come out of renovation are for multiscreen location. We feel the numbers will go up and down in the next couple of quarters and this number will stabilize in the long run.

**Amit Mehta**: You said that some screens would go for a minor renovation and some will for major, normally what is the timeframe for this renovation, how long it will take?

**Kapil Agarwal:** Minor renovation typically takes three to six months whereas the major renovation takes one to one and half years because they have to demolish the entire structure, rebuild it and take new permissions which usually takes time.

**Amit Mehta**: Once major renovation is over, further renovation is not required for 7 to 10 years, is it true?

**Kapil Agarwal:** Yes, when we talk about major renovation, it is actually converting a single screen theater into a multi-screen theater. It is not that every 8 to10 years they are doing a renovation. We are now looking at the potential, because of early availability of content due to digital cinema, people are actually demolishing these 1,000-800 seater screen theaters and converting them to two or three screens complex so that they can run more content in these theaters which can offer more variety to the audience.

**Moderator:** The next question is from the line of Suveer Chainani from the Citi.

**Suveer Chainani:** Can you provide some color on the Caravan growth, how is it and how intensive is it on the balance sheet?

**Kapil Agarwal:** It was and as a matter of fact it continues to be a high growth area. It is like any other typical new project, where you have to invest in the project initially then eventually it starts giving you the benefit. We started the year with 24 vans and as on October end, we already have 80 vans. Since monsoon is over, from October, Caravan Talkies has started generating revenues and we expect to increase the number of vans to 130-140 by the end of FY16. That means FY17 will be opening with probably 130-140 vans. Therefore it is going to bring substantial revenue. Eventually when this revenue stabilizes in next two to three years, we expect it to be a ~45% EBITDA margin business. From the current quarter itself, it will start contributing and as Mr. Gaikwad mentioned in the opening remarks, in six to nine months, it should become an EBITDA positive business. Right now we are in the investment phase and by end of next year it should start giving good returns.

**Moderator:** The next question is from Amit Kumar from Investec Capital.

**Amit Kumar:** Is there any further progress with respect to the deal that you had with Universal Studio to release some of the Hollywood films on E-cinema? Universal Studios this quarter released 'Minions' globally, did that find a release on your circuit and how was the response?

**Kapil Agarwal:** Globally, Hollywood Studios release 500 or 600 movies a year. India sees only 50 to 70 of those releases. Out of those 50 to70 releases, annually, there are probably 4 or 5 blockbusters which are mass movies. When any studio is releasing, Universal Studios per se, they look at releasing it on E Cinema, or all India's single screens they really consider the mass movies and that is where they released 'Fast and Furious 7' and 'Jurassic World', both the movies. 'Minions' and all were not mass movies. That is why they did not bring it to that circuit. Secondly, as far as the impact of this is concerned, it has created an awakening in the minds of Hollywood Studios. They have invested billions of dollars on D-Cinema globally. Earlier, they have taken a commitment that they will not release mainstream Hollywood movies on E-cinema platform. Now, after the huge success of 'Jurassic World' and 'Fast and Furious 7', it has really awakened these studios, so, most of the studios are actually looking at this avenue. They are considering this as lost revenue if they do not release the movie on our E-Cinema network. Thus, they are considering it and it is expected to take time. Over the next one and half years, couple of more studios should move on it. It is like turning a big ship which takes a lot of time, particularly if we consider globally. India is a very small revenue source for them, so taking a decision on India takes time. It is on the consideration of many studios and they are discussing this back and forth.

**Amit Kumar:** What are the rates effective from September on regional movies?

**Kapil Agarwal:** The regional market takes a very different structure and different rates unlike in the Hindi market, where we charge 'X' amount for first week and 'Y' amount for the second week and we don't charge third week onwards and cap it at ₹20,000. The regional structure was very different. Firstly, these rates were much lower, so we have taken a hike on those rates.

Secondly, we have changed the structure of those rates. Their VPF does not stop in two weeks. We keep sliding the rates, week on week. We charge for third and fourth week also. Thirdly, the structural change is that we limit the number of screens on which the movie releases for the application of the regional rates and in case the movie releases on more than 'N' number of screens in a particular region, we treat this as a mainstream Hindi movie and we charge the higher rates which are applicable for Hindi movies. It is the combination of the three that is increasing the pricing structure.

**Amit Kumar:** Could you please quantify it for me?

**Ashish Malushte:** Previously the regional rates were ₹240 per show in the first week of release which has now moved up to ₹300 per show. Similarly, the second week which was ₹150, third week used to be ₹120 and forth week from date of release used to be charged at ₹90 per show. These three rates have respectively moved to ₹240, ₹150 and ₹120. So, effectively that is close 25% to 32% increase in the rates.

**Moderator:** We take the next question from Ankur Periwal from Axis capital.

**Ankur Periwal:** We see there is a time lag of three to six months wherein the actual numbers got realized in our financials in terms of price hike taken with effect from April was visual in this quarter onwards.

**Kapil Agarwal:** There is no lag. This is implemented from April 1, 2015. All movies which released in Q1 paid the higher price. In the second quarter, we also changed the regional rates. So, you will see a higher impact in the second quarter because it is a cumulative impact of Hindi and regional, and in the last quarter it was only Hindi movies. That is one reason. Secondly, the number of regional movies released are far higher than Hindi movies. India makes only 170-180 Hindi movies out of 1,600 to 1,700 movies which get released in a year. So, it is all a function of how many movies released in Q1 and how many movies released in which language in a quarter. That is the only impact. This rate increase was effective immediately.

**Ankur Periwal:** Was there a time lag?

**Kapil Agarwal:** No time lag at all.

**Ankur Periwal:** The advertisement revenue shared with the exhibitors is more or less stable quarter-on-quarter, but if I remember last quarter you were discussing that probably over a period of time this number can come down further.

**Kapil Agarwal:** The sharing in H1FY15 was 36.1% and the sharing in H1FY16 has come down to 32.8%. There is already a reduction of 3.3% in this sharing. As the advertisement revenues go up, this will eventually keep coming down. And as we said in the beginning, that should stabilize at 26% to 27%.

**Ankur Periwal:** Can you share some outlook in terms of how the festive spend has been? Plus Q2 is typically a weaker quarter in terms of advertisement spent if compared to all the four quarters. How is Q3 shaping up?

**Kapil Agarwal:** Q3 sharing should be lower but I cannot quantify. It is purely dependent on the amount of advertising which happens because we are giving a minimum guarantees.

**Ankur Periwal:** How is the overall advertisement revenue shaping up?

**Kapil Agarwal:** Advertisement revenue typically in H1 contributes 40% to 45% and H2 contributes 55% to 60%, so by that measure we are seeing a growth in Q3 as well. Because of the festive season and more releases, the spent on advertising in Q3 and Q4 is expected to be significantly higher contributing 55% to 60% of total revenue. So, it will be higher revenue and consequently lower sharing in percentage terms.

**Moderator:** Next question is from the line of Amit Kumar from Investec Capitals.

**Amit Kumar:** What is the benchmark of number of screens beyond which you start charging the Hindi rates and specific to the example of Bahubali in Q2 which had a Hindi release as well as a fairly wide regional release in Telugu and Tamil. Was it applicable for Hindi rates or the regional rates?

**Kapil Agarwal:** Just give you the threshold, it is 150 screens. If it releases in more than 150 screens, we charge the main screen rate. As a consequence, for Bahubali we charge the main screen rate, not the regional movie rate.

We charge reduced rate on the regional movies instead of ₹395 or ₹420. We were charging ₹240 to subsidize and encourage the regional movies as they were small. That is why the lower rates were being charged. But if the movies became big, we asked for the main screen movie price and then you do not need any subsidization. With that logic behind, we did a structural change and that is how we started charging the higher rate.

**Sanjay Gaikwad:** We always had this threshold but it actually got triggered during Bahubali and got formalized during Bahubali.

**Moderator:** The next question is from the line of Amit Surekha from Bharti AXA Life Insurance.

**Amit Surekha:** You mentioned that Caravan business had contributed negative 64 bps this quarter. Would this business take time to ramp up? Is it safe to assume that in the intermediate period of six to nine months, this business should be giving negative margin of 50 to 60 bps?

**Kapil Agarwal:** Yes, it was 64bps in Q2FY16. But it will continue to slide down quarter-on-quarter, because the actual operations have started. This 64bps negative contribution arised because of zero operation due to monsoon, thus no revenue came and on the other hand there were only expenses. Revenues have started flowing in Q3. From the second week of October the vans have become operational. All 80 vans have become operational by the end of October. They are all contributing to the revenue. This should systematically come down and within six to nine months, it should go away. It will not contribute 50 to 60 bps negative. It will actually be contributing positively by the monsoon season next year. But it will contribute negatively next year during monsoons again because there will be no operation three to four months.

**Amit Surekha** H2 advertisement revenue should be better as compared to H1, will it also mean that H2 margins would be better than H1 margins?

**Kapil Agarwal** Yes, that is what is anticipated because advertisement revenue is directly contributing between 60% and 70% to the bottom line. After the share of 32.8% with the exhibitors, 10% to 15% cost of acquisition and other cost, so we are talking about 60% to 68% margin.

**Amit Surekha:** Will the margins for the full year be better than last year?

**Kapil Agarwal:** Yes, certainly. Last year we had ₹115 Crore advertisement revenue and this year we are projecting a 40% to 50% growth, even if I take 40% growth, that means I am talking about close to ₹160 Crore. When I am talking about ₹160 - ₹165 Crore growth, the sharing goes down and then obviously the margin should improve.

**Moderator:** I now hand the conference over to Mr. Suveer Chainani for his closing comments.

**Suveer Chainani:** On behalf of the management of the UFO Moviez and Citi, I would like to thank all the participants and wish you a very Happy Deepavali. Thank you.

**Moderator:** Ladies and gentlemen, on behalf of Citi that concludes this conference call. Thank you for joining us. You may now disconnect your lines.

The transcript has been edited for language and grammar, it however may not be a verbatim representation of the call.