UFO Moviez India Limited

January 31, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Loans	107.00	87.00	[ICRA]AA- (Stable); reaffirmed
Long-term, Fund-based Facilities	30.00	30.00	[ICRA]AA- (Stable); reaffirmed
Short-term, Non-fund Based Facilities	10.00	10.00	[ICRA]A1+; reaffirmed
Total	**147.00**	**127.00**	

*Instrument details are provided in Annexure-1

Rationale

The reaffirmation of ratings takes into account the well-established position of UFO Moviez India Limited (UMIL) in the digital cinema exhibition industry, with ~55% market share (in terms of number of screens digitised in the country) on a consolidated basis, and an experienced management team. The ratings continue to draw comfort from the healthy operating performance of the company, which has resulted in a strong financial risk profile as reflected by healthy cash accruals, low leverage (currently cash surplus), and comfortable debt coverage indicators and liquidity. Coupled with reduction in capital expenditure (capex) starting from FY2015, this has aided cash flows. ICRA also notes the Rs. 45.0 crore funds infused into the company through a preferential issue of equity shares (Rs. 30.0 crore) and share warrants application money (Rs. 15.0 crore) to the promoters during December 2017. The balance of Rs. 45.0 crore of the share warrants is to be received before June 2019, i.e., at the time of exercise of share warrants by the holders.

The ratings are constrained by the limited tenure of virtual print fee (VPF) income from the Hollywood studios, resulting in a gradual decline in Hollywood VPF income starting FY2017 and eventual expiry in FY2020, thereby impacting its profitability. The same is, however, expected to be adequately compensated by an increase in advertisement revenues. However, ICRA notes that the advertisement revenues in H1 FY2019 have witnessed a lower growth of 8.9%. Furthermore, UMIL has shared a higher percentage of advertisement revenues with film exhibitors in H1 FY2019—at 37.15%, as against 31.75% during FY2018. This has resulted in a decline in its operating profit margin (OPM) to 23.2% in H1 FY2019 from 28.7% in FY2018. Revival of advertisement revenue growth, and thus an improvement in OPM, are key rating monitorables. The ratings also take into account the limited potential for increasing the screen base, the limited life of projection systems, which would necessitate moderate levels of maintenance / replacement capex, going forward, and the vulnerability to changes in technology. ICRA further notes that UMIL's operating lease-based revenue model has required high initial investments in technology and projection systems (capex), which has historically been constraining its profitability. However, subsequent reduction in capex, coupled with continued strong growth in advertisement revenues, has aided improvement in return on capital employed (RoCE) to 19.8% in FY2018.

Sustained growth in advertisement revenues—through higher utilisation of inventory, improving earnings per advertisement slot, and generation of additional advertisement revenue streams (Nova Cinemas and Caravan Talkies)—remains key for further improvement in profitability. While UMIL's ability to maintain commercial terms (VPF / rentals) with its clients (film distributors and exhibitors) also remains key for sustained business growth, ICRA derives comfort from the large installed base of UMIL's systems among exhibitors and the acceptance of UMIL as a digital partner by the film distributors. The amount of replacement capex, going forward, remains a key rating monitorable.

In November 2017, UMIL had announced a business combination between itself and Qube Cinema Technologies Private Limited (QCTPL), through a composite scheme of arrangement and amalgamation, which is expected to result in significant operational synergies, in addition to the enhancement in value proposition that can be offered by the combined entity to its clients (film producers and distributors, theatre owners, and advertisement clients). On January 21, 2019, UMIL announced that the National Company Law Tribunal (NCLT) has dismissed the petition filed by the company for the approval of the scheme. The management is currently in the process of exploring its options pursuant to the decision of NCLT and will decide its course of action once it receives NCLT's order containing the grounds for dismissal of the scheme. ICRA will continue to monitor developments in this regard.

Outlook: Stable

ICRA expects UMIL to continue to benefit from its established position as a leading digital cinema technology and infrastructure provider to the film exhibitors in India and leverage this position to continue to grow its advertisement revenues. The outlook may be revised to Positive if the company shows a significant growth in its advertisement revenues compensating for the impact of D-cinema VPF sunset, resulting in healthy growth in turnover and improvement in profitability. On the other hand, the outlook may be revised to Negative if the cash accruals are lower than expected due to higher than estimated D-cinema VPF sunset impact and lower advertisement revenues, or if any major capex or debt-funded acquisition weakens liquidity.

Key rating drivers

Credit strengths

Leading digital cinema technology and infrastructure provider to film exhibitors in India – UMIL has established a strong market position by consolidating the industry, especially through the 100% stake acquired over the years in Scrabble Entertainment Limited (SEL), a digital cinema initiative (DCI) compliant system integrator. UMIL (consolidated, i.e., combined with SEL) is the leading digital cinema technology and infrastructure provider to film exhibitors in India, with a network of 5,302 screens in the country as on September 30, 2018. These screens include 1,674 DCI-compliant (D-cinema) screens and 3,628 non-DCI (e-cinema) screens across single screen theatres and multiplexes. UMIL and SEL together accounted for ~55% of the digital cinema screens in the country as on September 30, 2018.

Wide coverage of theatres across India provides critical mass to attract advertisers – UMIL has contracted 3,800 screens across the country, as on September 30, 2018, for in-cinema advertisement. Of these 1,237 are multiplexes and balance are single screen theatres in tier II and III cities and towns. With this infrastructure in place, UMIL has been able to attract advertisers, both Government and corporates, to display their advertisements on UMIL's cinema screens. During H1 FY2019, 1,144 advertisers used UMIL's in-cinema advertisement services. UMIL reported advertisement revenues of Rs. 94.2 crore during H1 FY2019 (PY: Rs. 86.5 crore) with Government (including public sector undertakings) clients driving ~48% of advertisement revenues and corporate (including hyper-local) clients accounting for the rest.

Strong financial profile as reflected by healthy cash accruals and comfortable capital structure as well as debt coverage indicators and healthy liquidity profile – Healthy operating cash flows coupled with the management's ability to raise equity to fund the growth have helped the company achieve a strong financial profile. As of September 30, 2018, UMIL (consolidated) had a robust capital structure with a comfortable gearing of 0.2 time. While the coverage indicators weakened in H1 FY2019 due to deterioration in UMIL's OPM, they continue to remain healthy with TD/OPBDITA of 0.8 time and interest coverage of 13.0 times as on September 30, 2018.

Professional and experienced management team – Mr. Sanjay Gaikwad, the founder and managing director of UMIL, has extensive experience in the media business. He is supported by a team experienced in various facets of business. During UMIL's initial years, the management was able to raise private equity to fund the growth requirements. The management's abilities were demonstrated when they provided an exit to the investors through an offer for sale in May 2015.

Credit challenges

Current high penetration levels of digital cinema in theatres limits growth prospects in terms of additions to screens – While the company has taken initiatives, such as Nova Cinemaz, to drive the establishment of new screens in the country, no major increase in number of screens is expected over the medium term. While the competitive intensity in the industry is moderate with UMIL and QCTPL accounting for ~95% of the digitised screens in the country, UMIL has been witnessing some churn in its screens owing to aggressive rental terms offered (to the film exhibitors) by some of the regional players. However, it is likely that these film exhibitors return to UMIL over the longer term on the back of UMIL's ability to provide content and generate advertisement revenues for the theatres.

Risks of changes in technology, although partly mitigated by the strong installed base of UMIL systems among film exhibitors in India – UMIL, being present in a technology intensive media business, is exposed to the risks associated with any technological disruptions leading to complete change in the business landscape. However, given that UMIL (along with SEL) has established a wide network of digital cinema screens across the country, and is offering theatres a sustainable business model by providing a share in advertisement revenues, it will be difficult for a new player (with new technology) to replace UMIL's systems, unless backed by a sustainable business plan for all stakeholders.

Operating lease-based revenue model has required high investments by UMIL, which has been constraining the RoCE; limited life of projection systems necessitates continuous investment in replacement of older projection systems – ICRA notes that UMIL's operating lease-based revenue model has required high initial investments in technology and projection systems, which has historically been constraining its profitability. However, subsequent reduction in capex coupled with continued strong growth in advertisement revenues has aided improvement in RoCE to 19.8% in FY2018.

Liquidity Position

UMIL's fund flow from operations has been positive over the years due to healthy profitability. Coupled with its low working capital intensity of operations, this has resulted in positive cash flow from operations. While higher capex towards purchase of digital projection systems was constraining the free cash flows in the past, considerable reduction in capex requirements resulted in positive free cash flows (before debt repayments) from FY2015. In the current fiscal, the capex requirement has reduced further, with the company having incurred a capex of Rs. 17.5 crore in H1 FY2019, with a full year capex estimated at Rs. 35-36 crore. The liquidity position of the company remains strong, as reflected by consolidated cash and bank balances as well as liquid investments aggregating to Rs. 201.2 crore as on September 30, 2018. Furthermore, UMIL's Rs. 30.0 crore working capital limit largely remains unutilised.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	[Corporate Credit Rating Methodology]
Parent / Group Support	Not Applicable
Consolidation / Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of UMIL. As on September 30, 2018, the company had seven subsidiaries and four step-down subsidiaries, which are all listed in Annexure-2.

About the company

UFO India Limited (UIL) was incorporated in 2004 to provide digital cinema services in India. In 2005, UFO Moviez Limited (UML) was formed as a holding company and majority shareholding of UIL was vested in UML. Subsequently, in May 2008, UML was amalgamated with UIL; and following the amalgamation, UIL was renamed as UFO Moviez India Limited (UMIL). UMIL was originally promoted by the Valuable Group and the Apollo Group. The promoters, over the years, diluted their stake in the company to private equity investors (3i Digital Media (3i) in January 2007 and Providence Equity Partners (PEP) in May 2011) to meet the growth funding requirements. As on December 31, 2018, while the promoters held 30.09% stake and PEP held 18.52% stake in UMIL, 3i fully exited its investment in UMIL. UMIL is listed on the Bombay Stock Exchange and the National Stock Exchange.

UMIL operates as an infrastructure service provider for the film distribution and exhibition industry. UMIL receives analogue movie prints from film producers / distributors, and then digitises, compresses, encrypts and transmits the same through satellite to authorised exhibitors. It also facilitates the exhibitors to screen digital cinema by providing them with the required infrastructure—such as satellite dishes, servers, digital projectors and UPS. UMIL, thus, offers cost and time arbitrage to the film industry. UMIL also facilitates advertisers to showcase their advertisements on screen during a movie show. UMIL is currently the leading digital cinema infrastructure provider to theatres in India, with a screen market share of ~55% (consolidated level).

For the 12 months that ended on March 31, 2018, on a consolidated basis, UMIL reported a profit after tax (PAT) of Rs. 54.1 crore on an operating income (OI) of Rs. 594.0 crore, as against a PAT of Rs. 53.3 crore on an OI of Rs. 599.0 crore for the 12 months that ended on March 31, 2017.

As per unaudited financials for the six-months period that ended on September 30, 2018, UMIL, on a consolidated basis, reported a PAT of Rs. 14.1 crore on an OI of Rs. 268.2 crore.

Key financial indicators (audited, consolidated)

	FY2017	FY2018
Operating Income (Rs. crore)	599.0	594.0
PAT (Rs. crore)*	53.3	54.1
OPBDIT/ OI (%)	31.0%	28.7%
RoCE (%)	18.6%	19.8%
Total Debt/ TNW (times)	0.2	0.2
Total Debt/ OPBDIT (times)	0.5	0.5
Interest Coverage (times)	13.5	18.6

** excluding share of profits from associates*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Type	Current Rating (FY2019) Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)*	Date & Rating January 2019	Chronology of Rating History for the Past 3 Years: Date & Rating in FY2018 December 2017	November 2017	April 2017	Date & Rating in FY2017 April 2016	Date & Rating in FY2016 -
1	Term Loan	Long-term	87.0	87.0	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- &	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	-
2	Fund-based Facility	Long-term	30.0	-	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- &	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	-
3	Non-fund Based Facility	Short-term	10.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+ &	[ICRA]A1+	[ICRA]A1+	-

**As on March 31, 2018; & - On rating watch with developing implications*

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan 1	Aug-16	9.0%-9.25%	Jun-19	37.00	[ICRA]AA- (Stable)
NA	Term Loan 2	Oct-16	9.85%	Jun-21	50.00	[ICRA]AA- (Stable)
NA	Fund-based Facility – Cash Credit	-	-	-	30.00	[ICRA]AA- (Stable)
NA	Non-fund Based Facility – Letter of Credit	-	-	-	10.00	[ICRA]A1+

Source: UFO Moviez India Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Scrabble Entertainment Limited	100%	Full Consolidation
Valuable Digital Screen Private Limited	100%	Full Consolidation
United Film Organisers Nepal Private Limited	100%	Full Consolidation
PJSA Technosoft Private Limited	100%	Full Consolidation
United Film Organisers (UFO) (Mauritius) Private Limited	100%	Full Consolidation
UFO Lanka Private Limited	100%	Full Consolidation
UFO Software Technologies Private Limited	100%	Full Consolidation
Scrabble Entertainment DMCC	100%	Full Consolidation
Scrabble Entertainment Mauritius Limited	100%	Full Consolidation
Scrabble Entertainment Lebanon SARL	100%	Full Consolidation
Scrabble Digital Inc	100%	Full Consolidation

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About ICRA Limited:

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