January 07, 2021

UFO Moviez India Limited: Ratings reaffirmed; outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Loans	97.31	97.31	[ICRA]A+ reaffirmed; Outlook revised to Negative from Stable
Long-term, Fund-based Facilities	75.0	75.0	[ICRA]A+ reaffirmed; Outlook revised to Negative from Stable
Short-term, Non-fund Based Facilities	10.0	10.0	[ICRA]A1; reaffirmed
Total	**182.31**	**182.31**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in outlook on the long-term rating of UFO Moviez India Limited (UMIL) factors in the significant disruptions to its operations caused by the Covid-19 pandemic and delayed recovery in operations. This resulted in a net loss of Rs. 63.9 crore for UMIL (consolidated) in H1 FY2021, against a profit after tax (PAT) of Rs. 4.6 crore in H1 FY2020. Despite the Government of India allowing opening of theatres with effect from October 15, 2020, not many theatres have opened up owing to very few movie releases and low footfalls as there are very few new releases and majority of the cinemas are playing old content, which is complimented by some scepticism amongst audience to visit the theatres amid the pandemic.

The ratings continue to factor in the company's strong financial risk profile as reflected by its adequate liquidity position and low leverage. As on November 30, 2020, UMIL (consolidated) had unencumbered cash and bank balance and liquid investments of Rs. 93.7 crore, against a gross debt (excluding lease liabilities) of Rs. 99.9 crore. This is, however, lower than the unencumbered cash and bank balance and liquid investments of Rs. 111.4 crore as on March 31, 2020, against a gross debt (excluding lease liabilities) of Rs. 70.0 crore. The ratings continue to factor in its well-established position in the digital cinema exhibition industry, with ~55% market share (in terms of the number of digitised screens in the country) on a consolidated basis and an experienced management team.

UMIL has undertaken several cost rationalisation measures including ~37% cut in employee salaries in Q1 FY2021 and another 33% cut (on the reduced base) with effect from August 01, 2020 and in other fixed overheads and expenses. ICRA believes these cost control initiatives will help the company in reducing the cash outflows. However, the ramp up in revenues will be only gradual as footfalls will take time to recover as the content pipeline builds up amid the ongoing virus scare. UMIL's earnings are thus expected to be adversely impacted in FY2021, as corporates (across key sectors) are likely to cut back on their discretionary advertisement spends. Even Government spends on advertisement revenues will remain subdued over the near term. UMIL, like the film exhibitors, remain exposed to a significant risk of many movies (including the big budget ones) being released on over-the-top (OTT) platforms in the event of delays in opening theatres and/or ramp up of footfalls. This is a key rating monitorable.

ICRA also notes the limited tenure of D-Cinema virtual print fee (VPF) income from the Hollywood studios has resulted in a gradual decline in Hollywood VPF income starting FY2016 and eventual expiry in FY2020, thereby impacting its operating profit margin (OPM). ICRA also notes that the company did not charge any VPF for November and December 2020 and has offered discounts during January to March 2021. Any further material changes in the terms of the VPF for D-Cinema or E-Cinema (Bollywood producers) is a key rating monitorable. The 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 short life of projection systems, which would necessitate moderate levels of maintenance / replacement capital expenditure (capex), going forward, and the vulnerability to changes in technology. ICRA also factors in UMIL's operating lease-based revenue model, which has required high initial investments in technology and projection systems (capex), thus historically constraining its profitability.

While UMIL's ability to maintain commercial terms (VPF / rentals) with its clients (film producers/ distributors and exhibitors) remains the key for sustained business growth, ICRA derives comfort from the large installed base of its systems among exhibitors and the acceptance of UMIL as a digital partner by film producers / distributors.

ICRA also notes that the company has diversified into the film distribution business, where it shall not be bearing any content risk.

Key rating drivers and their description

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 5,142 screens across India as on September 30, 2020. These screens include 1,768 D-Cinema screens and 3,374 E-Cinema screens across single screen theatres and multiplexes. UMIL and SEL together account for ~55% of the digital cinema screens in the country.

Wide coverage of theatres across India attracting advertisers – In Q3 FY2020, along with the launch of a new logo, the company introduced a new brand identity, UFO Cine Media Network (UCMN), to reinforce its focus on in-cinema advertising. With the introduction of UCMN, the company is realigning its advertisement network into two channels – prime screens (2,002; multiplexes and Hollywood release centres as on March 31, 2020) and popular screens (1,790; standalone screens and mass appeal screens as on March 31, 2020). However, in FY2020, UMIL's advertisement revenues dipped by ~35% mainly on account of the decline in the Central Government's revenues (which witnessed a YoY decrease of 77%). In addition, the gradual shutdown of theatres with effect from March 11, 2020 impacted its advertisement revenues.

Comfortable capital structure along with adequate 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 on September 30, 2020, UMIL (consolidated) had a robust capital structure with total outside liabilities / tangible net worth (TOL/TNW) of 0.7 times. It had unencumbered cash and bank balance, along with liquid investments of Rs. 93.7 crore, against a gross debt (excluding lease liabilities) of Rs. 99.9 crore as on September 30, 2020.

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 the business. During UMIL's initial years, the management was able to raise private equity to fund its growth requirements. The management's abilities were also demonstrated when they provided an exit to its investors through an offer for sale in May 2015.

Credit challenges

Significant operational disruptions in FY2021 due to pandemic – ICRA notes the significant disruptions to UMIL's operations due to the pandemic and delayed recovery in operations.

This resulted in a net loss of Rs. 63.9 crore for UMIL (consolidated) in H1 FY2021, against PAT of Rs. 4.6 crore in H1 FY2020. Despite the Government of India allowing opening of theatres with effect from October 15, 2020, not many theatres have opened up owing to very few movie releases and low footfalls as there are very few new releases and majority of the cinemas are playing old content, which is complimented by some scepticism amongst audience to visit the theatres amid the pandemic.

However, the company has undertaken several cost rationalisation measures including ~37% cut in employee salaries in Q1 FY2021 and another 33% cut (on the reduced base) with effect from August 01, 2020 and in other fixed overheads and expenses. ICRA believes these cost control initiatives will help the company reduce cash outflows. However, the ramp up in revenues will be only gradual as footfalls will take time to recover as the content pipeline builds up amid the ongoing virus scare. UMIL's earnings are thus expected to be adversely impacted in FY2021, as corporates (across key sectors) are likely to cut back on their discretionary advertisement spends. Even Government spends on advertisement revenues will remain subdued over the near term. UMIL, like film exhibitors, remain exposed to a significant risk of many movies (including big budget productions) being released on OTT platforms in the event of delays in opening theatres and/or in ramp up of footfalls. This is a key rating monitorable.

Reduced financial flexibility due to sharp decline in share price – The company's share price has declined significantly during the last 12 to 18 months, resulting in reduced financial flexibility. ICRA notes the high dividend payout (including DDT) of ~Rs. 148.13 crore in FY2020 (including Rs. 30 per share dividend announced for FY2019 and the interim dividend of Rs. 15 per share announced on February 27, 2020).

Any material changes in VPF for D-Cinema or E-Cinema (Bollywood producers) remain crucial – Limited tenure of D-Cinema VPF income from the Hollywood studios has resulted in a gradual decline in Hollywood VPF income starting from FY2016, and eventual expiry in FY2020, thereby impacting its OPM. ICRA notes that the company did not charge any VPF for November and December 2020 and has offered discounts for the months of January to March 2021. Any further material changes in the terms of the VPF for D-Cinema or E-Cinema (Bollywood producers) is a key rating monitorable.

High penetration levels of digital cinema in theatres limiting growth prospects in terms of screen additions – With almost full digitisation of theatres in India, there is a limited potential for increasing the screen base. While it 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 competition in the industry is moderate, with UMIL accounting for ~55% of the digitised screens in the country, the company 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 its ability to provide content and generate advertisement revenues for the theatres.

Risks of changes in technology despite strong installed base of UMIL's 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 its systems, unless backed by a sustainable business plan for all stakeholders.

Operating lease-based revenue model requires high investments; limited life of projection systems – ICRA notes that UMIL's lease-based revenue model has required high initial investments in technology and projection systems, which has historically constrained its profitability.

Liquidity position: Adequate

UMIL's liquidity position is **adequate**. While its earnings are expected to be adversely impacted in FY2021, as on November 30, 2020, UMIL (consolidated) had total cash and bank balance and liquid investments of Rs. 93.7 crore, against gross debt (excluding lease liabilities) of Rs. 99.9 crore. Overall, UMIL (consolidated) has long-term debt repayment of Rs. 14.1 crore during December 2020 – March 2021 and minimal capex plans. The company received an income tax refund of ~Rs. 15 crore in December 2020, which will also support its liquidity position.

Rating sensitivities

Positive triggers – An upgrade is unlikely in the near term. However, ICRA could revise the outlook on UMIL's ratings to Stable if the company shows a sustained improvement in its profitability, supported by significant growth in its scale of operations.

Negative triggers – UMIL's ratings may be downgraded in case of prolonged impact of the pandemic leading to sustained weakening in performance and deterioration in liquidity or coverage metrics. Negative pressure on the ratings could also arise in case of any further adverse changes in the terms of the VPF with Bollywood producers, thereby impacting its revenues and profitability, or if any major capex or debt-funded acquisition affects its credit metrics. Any further moderation in the company's liquidity position on account of high dividend payouts would also be a negative trigger.

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 March 31, 2020, the company had six subsidiaries, five step-down subsidiaries and six associates, 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 the majority shareholding of UIL was vested in UML. Subsequently, in May 2008, UML was amalgamated with UIL. 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, or 3i, in January 2007 and Providence Equity Partners, or PEP, in May 2011) to meet the growth funding requirements. As on September 30, 2020, while the promoters held 30.53% stake and PEP held 18.52% stake in UMIL, 3i fully exited its investment in UMIL. It 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 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). In December 2020, UMIL also announced its entry into the film distribution business.

Key financial indicators (audited, consolidated)

Consolidated	FY2019	FY2020
Operating Income (Rs. crore)	611.9	502.1
PAT (Rs. crore)*	61.4	34.8
OPBDIT/OI (%)	27.0%	23.6%
PAT/OI (%)	10.0%	6.9%
Total Outside Liabilities/Tangible Net Worth (times)	0.5	0.6
Total Debt/OPBDIT (times)	0.5	0.8
Interest Coverage (times)	15.0	11.7

**excluding net share of profit from associates and non-controlling interest*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Type	Current Rating (FY2021)				Chronology of Rating History for the Past 3 Years							
			Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore) *	Date & Rating		Date & Rating in FY2020			Date & Rating in FY2019		Date & Rating in FY2018		
					7-Jan-21	4-Sep-20	13-Mar-20	5-Nov-19	16-Sep-19	1-Mar-19	31-Jan-19	21-Dec-17	9-Nov-17	11-Apr-17
1	Term Loans	Long-term	97.31	79.81	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- &	[ICRA]AA- (Stable)
2	Fund-based Facility	Long-term	75.0	-	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- &	[ICRA]AA- (Stable)
3	Non-fund Based Facility	Short-term	10.0	-	[ICRA]A1	[ICRA]A1	[ICRA]A1	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+ &	[ICRA]A1+

**As on September 30, 2020; &: 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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Term Loan 1	FY2018	9.36%	Jun-22	35.84	[ICRA]A+ (Negative)
-	Term Loan 2	Oct-16	9.70%	Jun-21	15.10	[ICRA]A+ (Negative)
-	Term Loan 3	Oct-19	9.30%	FY2024	44.50	[ICRA]A+ (Negative)
-	Term Loan 4	Jun-17	9.85%	Dec-20	1.87	[ICRA]A+ (Negative)
-	Fund-based Facility	-	-	-	75.0	[ICRA]A+ (Negative)
-	Non-fund Based Facility – Letter of Credit	-	-	-	10.0	[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
UFO Lanka Private Limited	100%	Full Consolidation
UFO Software Technologies Private Limited	95.97%	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
Scrabble Digital Limited (w.e.f. December 14, 2018)	100%	Full Consolidation
Scrabble Digital DMCC	33.33%	Equity Method
Scrabble Venture LLC	30%	Equity Method
Scrabble Ventures, S. de R.L. de C.V, Mexico	30%	Equity Method
Mukta V N Films Private Limited	48.12%	Equity Method
Scrabble Audio Visual Equipment Trading LLC (w.e.f. November 25, 2018)	49%	Equity Method
Cinestaan Digital Private Limited	18.75%	Equity Method

** As on March 31, 2020*

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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