UFO Moviez India Limited

December 21, 2017

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based – Term Loan	107.00	107.00	[ICRA]AA-; Re-affirmed; Removed from 'watch with developing implications'; Stable outlook assigned
Fund-based – Working Capital Facilities	30.00	30.00	[ICRA]AA-; Re-affirmed; Removed from 'watch with developing implications'; Stable outlook assigned
Non-fund based – Working Capital Facilities	10.00	10.00	[ICRA]A1+; Re-affirmed; Removed from 'watch with developing implications'
Total	**147.00**	**147.00**	

* Instrument details are provided in Annexure-1

Rating action

ICRA has re-affirmed the long-term rating of [ICRA]AA- (pronounced ICRA double A minus) assigned to the Rs. 107.00 crore[1] term loans and the Rs. 30.00 crore fund-based working capital facilities of UFO Moviez India Limited ('UMIL')[2]. ICRA has also re-affirmed the short-term rating of [ICRA]A1+ (pronounced ICRA A one plus) assigned to the Rs. 10.00 crore non-fund based working capital facilities of UMIL. The ratings have been removed from 'rating watch with developing implications' and the long-term rating has been assigned a 'Stable' outlook.

Rationale

The re-affirmation of ratings and removal of rating watch takes into account the consistent robust 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. This coupled with reduction in capital expenditure (capex) starting from FY2015 has aided cash flows.

The ratings continue to draw comfort from the experienced management team and the well-established position of UMIL in the digital cinema exhibition industry, with ~54% market share (in terms of number of screens digitised in the country) on a consolidated basis. Furthermore, UMIL has announced a business combination between itself and Qube Cinema Technologies Private Limited (QCTPL), though a composite scheme of arrangement and amalgamation. This is expected to result in a combined screen market share of ~80% for the merged entity. As per the discussion with the management, the proposed business combination 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). The proposed business combination, subject to various regulatory and statutory approvals, is expected to be concluded by Q2 FY2019. ICRA also takes note of the Rs. 90 crore funds infusion into the company through a preferential issue of equity shares (Rs. 30 crore) and share warrants (Rs. 60 crore) to the promoters during December 2017 (Rs. 45 crore to be received in December 2017 and balance Rs. 45 crore to be received before June 2019 i.e. at the time of exercise of share warrants by the holders).

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[1] *100 lakh = 1 crore = 10 million*

[2] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

The ratings are, however, constrained by 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 (ad) revenues has aided improvement in return on capital employed (RoCE) to 19.1% in FY2017. Sustained growth in ad revenues—through higher utilisation of ad inventory, improving earnings per ad slot, and generation of additional ad revenue streams (UFO Framez and Caravan Talkies)—remains key for further improvement in profitability. While UMIL's ability to maintain commercial terms (virtual print fee–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 quantum of replacement capex going forward remains a key rating monitorable.

Outlook: Stable

ICRA believes UMIL will 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. ICRA also believes that the proposed amalgamation scheme with QCTPL will further consolidate UMIL's dominant position in the industry, and further benefit from the operational synergies. The outlook may be revised to 'Positive' if the synergies from the proposed business combination are higher than ICRA's estimates, thus resulting in better than expected RoCE. The outlook may be revised to 'Negative' if cash accruals are lower than expected due to higher than estimated D-cinema VPF sunset, 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 5,384 screens in the country (includes 122 screens in Nepal, as it forms part of Indian Film Territory) as on September 30, 2017. These screens include 1,567 DCI-compliant (D-cinema) screens and 3,817 non-DCI (E-cinema) screens across single screen theatres and multiplexes. UMIL and SEL together account for ~54% of the digital cinema screens in the country as on September 30, 2017.

Wide coverage of theatres across India provides critical mass to attract advertisers – UMIL has contracted 4,021 screens, as on September 30, 2017, for in-cinema advertisement. These screens are located across the country and comprise largely 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 FY2018, 1,888 advertisers used UMIL's in-cinema advertisement services. UMIL reported advertisement revenues of Rs. 86.5 crore during H1 FY2018 (PY: Rs. 91.4 crore) with government (including public sector undertakings) clients accounting for ~48% of advertisement revenues and corporate (including hyper-local) clients accounting for the balance.

Robust operating performance over the years; improving scale of operations facilitating better operating leverage – Aided by its established market position amongst the film industry stakeholders (film exhibitors, film producers / distributors and advertisers), UMIL has posted a robust operating performance over the years, as reflected by ~24% compounded annual growth rate (CAGR) in consolidated operating income during FY2012 to FY2017 and consistent operating profit margin of 30%-34%. The growth has been driven by ~37% CAGR in in-cinema advertisement revenues, ~24% CAGR in VPF revenues from film distributors, and ~18% CAGR in lease rental income from exhibitors.

Strong financial profile as reflected by healthy cash accruals, low working capital intensity, and comfortable capital structure and debt coverage indicators, and resulting financial flexibility – Healthy operating cash flows coupled with the management's ability to raise equity to fund the growth have helped the company in achieving a strong financial profile. As of September 30, 2017, UMIL (consolidated) has a comfortable capital structure (gearing of 0.17 times) and a healthy liquidity profile (cash and cash equivalents of Rs. 128.11 crore, as against total debt of Rs. 64.25 crore, and unutilised bank limits of more than Rs. 15 crore).

Professional and experienced management team – Mr. Sanjay Gaikwad, the 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 weaknesses

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 setting up 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 more than 90% 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 ad revenues for the theatres.

Risks of changes in technology; though partly mitigated by the strong installed base of UMIL systems amongst film exhibitors in India – UMIL, being present in 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 the 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 the 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 towards 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 19.1% in FY2017.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

Corporate Credit Rating Methodology

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 post 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, have 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) in order to meet the growth funding requirements. Currently, while the promoters hold 28.13% stake and PEP holds 19.03% stake in UMIL, 3i has fully exited its investment in UMIL. UMIL is listed on Bombay Stock Exchange and National Stock Exchange.

UMIL operates as an infrastructure service provider for film distribution and exhibition industry. UMIL receives the analogue movie print from the producer / distributor, and then digitises, compresses, encrypts and transmits the same through satellite to the authorised exhibitors. It also facilitates the exhibitors to screen the digital cinema by providing them the required infrastructure—includes satellite dish, server, digital projector and UPS. UMIL, thus, offers cost and time arbitrage to the film industry. UMIL also facilitates the advertisers to showcase their advertisements on screen during a movie show. UMIL is currently the leading digital cinema infrastructure provider to the theatres in India, with a screen market share of ~54% (consolidated level).

As per unaudited financials for the six-months period ended September 30, 2017, UMIL, on a consolidated basis, reported a profit after tax (PAT) of Rs. 24.23 crore on an operating income (OI) of Rs. 293.59 crore, as compared to a PAT of Rs. 26.61 crore on an OI of Rs. 295.45 crore during the corresponding period last year.

As per audited financials for FY2017, UMIL, on a consolidated basis, reported a PAT of Rs. 59.70 crore on an OI of Rs. 597.21 crore, as against a PAT of Rs. 63.47 crore on an OI of Rs. 570.06 crore during FY2016.

Key Financial Indicators (Audited)

	FY2016	FY2017
Operating Income (Rs. crore)	570.06	597.21
PAT (Rs. crore)	63.47	59.70
OPBDIT/ OI (%)	32.1%	30.6%
RoCE (%)	18.7%	19.1%
Total Debt/ TNW (times)	0.20	0.20
Total Debt/ OPBDIT (times)	0.57	0.46
Interest coverage (times)	13.03	17.88
NWC/ OI (%)	7%	3%

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work-in-Progress); NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Type	Current Rating (FY2018) Amount Rated (Rs. crore)	Amount Outstanding as on March 31, 2017 (Rs. Crore)	Date & Rating December 2017	Date & Rating November 2017	Date & Rating April 2017	Chronology of Rating History for the past 3 years: Date & Rating in FY2016 March 2016	Date & Rating in FY2015 March 2015	Date & Rating in FY2014 October 2013
1	Fund-based – Term Loan	Long-Term	107.00	104.40	[ICRA]AA- (Stable)	[ICRA]AA- &	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A- (Stable)
2	Fund-based – Working Capital Facilities	Long-Term	30.00	-	[ICRA]AA- (Stable)	[ICRA]AA- &	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A- (Stable)
3	Non-fund based – Working Capital Facilities	Short-Term	10.00	-	[ICRA]A1+	[ICRA]A1+ &	[ICRA]A1+	[ICRA]A1+	[ICRA]A1	[ICRA]A2+

&: 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-2016	NA	Jun-2019	57.00	[ICRA]AA- (Stable)
NA	Term Loan 2	Oct-2016	NA	Jun-2021	50.00	[ICRA]AA- (Stable)
NA	Cash Credit	NA	NA	NA	30.00	[ICRA]AA- (Stable)
NA	Letter of Credit	NA	NA	NA	10.00	[ICRA]A1+

Source: UFO Moviez India Limited

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About ICRA Limited:

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