March 13, 2020

UFO Moviez India Limited: Ratings downgraded to [ICRA]A+/[ICRA]A1; outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Loans	102.6	102.6	[ICRA]A+ (Stable); downgraded from [ICRA]AA- (Negative)
Long-term, Fund-based Facilities	75.0	75.0	[ICRA]A+ (Stable); downgraded from [ICRA]AA- (Negative)
Short-term, Non-fund Based Facilities	10.0	10.0	[ICRA]A1; downgraded from [ICRA]A1+
Total	**187.6**	**187.6**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in ratings of UFO Moviez India Limited (UMIL) factors in the significant YoY decline of 32% in the company's advertisement revenues during Q3 FY2020 and 21% during 9M FY2020. The advertisement revenue decline in Q3 FY2020 was led by 46% YoY decline in the revenues from the Government and public sector undertaking (PSU) segment (39% decline in 9M FY2020), 87.8% decline in revenues from the Caravan segment (57.5% decline in 9M FY2020) and 10% decline in the corporate segment (YoY growth of 2% in 9M FY2020). This resulted in a de growth in UMIL's operating profit margin (OPM) to 23.1% in Q3 FY2020 (pre-Ind AS 116), as against 26.2% in Q3 FY2019; and to 22.3% in 9M FY2020, as against 24.3% in 9M FY2019. Furthermore, Q4 FY2020 is expected to witness a YoY decline in revenues thanks to the impact on both advertisement revenues and continued decline in D-cinema virtual print fee (VPF) income. ICRA notes the high dividend payout (including dividend distribution tax (DDT)) of ~Rs. 148.13 crore in FY2020 (includes Rs. 30 per share dividend announced for FY2019 and the recent interim dividend of Rs. 15 per share announced on February 27, 2020). This has reduced UMIL's liquidity buffer. The company's share price has also witnessed continued decline, thereby impacting its financial flexibility.

The ratings continue to factor in the well-established position of 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 rating continues to draw comfort from the strong financial risk profile, as reflected by healthy cash accruals, low leverage and comfortable debt coverage indicators.

The rating is constrained by the limited tenure of D-cinema VPF income from the Hollywood studios, resulting in a gradual decline in Hollywood VPF income starting FY2016 and eventual expiry in FY2020, thereby impacting its OPM. Any material change in the terms of the VPF for D-Cinema or E-Cinema (Bollywood producers) is a key rating monitorable. The same is, however, expected to be compensated by an increase in advertisement revenues. Revival of advertisement revenue growth, and thus an improvement in OPM, are key rating monitorables. The rating also takes into account the limited potential for increasing the screen base, the limited 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 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.

Sustained growth in advertisement revenues—through higher utilisation of inventory, improving earnings per advertisement slot and generation of additional advertisement revenue streams (Nova Cinemaz and Caravan Talkies)—remains key for improvement in profitability. While UMIL's ability to maintain commercial terms (VPF / rentals) with its clients (film producers / 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 producers / 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. As a part of the arrangement, UMIL and ICICI Venture Funds Management Company Limited (ICICI Venture) were to purchase an aggregate of 53.2% stake in QCTPL from certain private equity (PE) investors. On January 21, 2019, UMIL announced that the National Company Law Tribunal (NCLT) had dismissed the petition filed by the company for the approval of the scheme citing several adverse comments. Furthermore, on February 21, 2019, UMIL informed the decision of ICICI Venture to terminate the Implementation Agreement and Share Purchase Agreement related to the scheme of amalgamation between UMIL and QCTPL. UMIL had appealed to the National Company Law Appellate Tribunal (NCLAT) challenging the order of NCLT, Mumbai, on February 25, 2019. NCLAT, in its order dated October 24, 2019, allowed the appeal and set aside the NCLT order. Furthermore, the NCLAT order recorded that the representative of the Union of India, Ministry of Corporate Affairs, through the Regional Director, Western Region had conceded before the NCLAT that the grounds given for rejection of the Scheme in the NCLT order were uncalled for and that NCLT was only required to notice all the requirements of Section 230-232 of the Companies Act, 2013. ICRA will continue to monitor the developments with regards to the amalgamation / acquisition of QCTPL by UMIL.

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 5,181 screens across the country as on December 31, 2019. These screens include 1,715 D-Cinema screens and 3,466 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 provides critical mass to attract 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 (1,847; multiplexes and Hollywood release centres as on December 31, 2019) and popular screens (1,796; standalone screens and mass appeal screens as on December 31, 2019). UMIL reported in-cinema advertisement revenues of Rs. 118 crore in 9M FY2020, representing a YoY decline of 16.5% and total advertisement revenues of Rs. 124.5 crore, representing a YoY decline of 21%. The advertisement revenue decline in Q3 FY2020 was led by 46% YoY decline in the revenues from the Government and PSU segment (39% decline in 9M FY2020), 87.8% decline in revenues from the Caravan segment (57.5% decline in 9M FY2020) and 10% decline in the corporate segment (YoY growth of 2% in 9M FY2020). This resulted in a de growth in UMIL's OPM to 23.1% in Q3 FY2020 (pre-Ind AS 116), as against 26.2% in Q3 FY2019; and to 22.3% in 9M FY2020, as against 24.3% in 9M FY2019. Furthermore, Q4 FY2020 is also expected to witness a YoY decline in revenues due to the impact on both advertisement revenues and continued decline in D-cinema VPF income. Revival of advertisement revenue growth, and thus an improvement in OPM, are key rating monitorables.

Strong financial profile as reflected by healthy cash accruals and comfortable capital structure as well as debt coverage indicators – 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 March 31, 2019, UMIL (consolidated) had a robust capital structure with total outside liabilities / tangible net worth (TOL/TNW) of 0.5 time. The coverage indicators remain healthy with total debt/ operating profits before depreciation, interest and tax (TD/OPBDITA) of 0.8 time and interest coverage of 15.0 times in FY2019. Furthermore, the company had net cash surplus of Rs. 89 crore as on December 31, 2019. However, the same is expected to witness moderation due to the interim dividend of Rs. 15 per share announced by the company on February 27, 2020, resulting in a total payout (including DDT) of ~Rs. 45.69 crore in Q4 FY2020.

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 demonstrated when they provided an exit to the investors through an offer for sale in May 2015.

Credit challenges

Reduced financial flexibility and moderation in liquidity profile – The share price of the company has declined significantly in the last 12 months, resulting in reduced financial flexibility. ICRA notes the high dividend payout (including DDT) of ~Rs. 148.13 crore in FY2020 (includes Rs. 30 per share dividend announced for FY2019 and the recent interim dividend of Rs. 15 per share announced on February 27, 2020). This has reduced UMIL's liquidity buffer.

Any material change in the terms of the VPF for D-Cinema or E-Cinema (Bollywood producers) is a key rating monitorable – Limited tenure of D-Cinema 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 UMIL's OPM. Any material change in the terms of the VPF for D-Cinema or E-Cinema (Bollywood producers) is a key rating monitorable.

Current high penetration levels of digital cinema in theatres limits 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 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 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 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 requires high investments by UMIL; 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 constrained its profitability.

Liquidity position: Adequate

UMIL's liquidity position is adequate. While it had a net cash surplus of Rs. 89 crore as on December 31, 2019, the same is expected to witness moderation considering the interim dividend of Rs. 15 per share declared by the company on February 27, 2020, resulting in a total payout (including DDT) of ~Rs. 45.69 crore in Q4 FY2020. 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. In the current fiscal, the capex requirement for UMIL is ~Rs. 45-55 crore, which is expected to be funded through a mix of term loans and internal accruals.

Rating sensitivities

Positive triggers: ICRA could upgrade UMIL's rating if the company shows a sustained improvement in its profitability supported by significant growth in its scale of operations along with an improvement in its return on capital employed (RoCE) above 20% on a sustained basis.

Negative triggers: Negative pressure on UMIL's rating could arise in case of any 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 resulted in a deterioration in its credit metrics. Any further moderation in the company's liquidity position on account of high dividend pay-outs 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, 2019, the company had six subsidiaries, five step-down subsidiaries and five 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; 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, or 3i, in January 2007 and Providence Equity Partners, or PEP, in May 2011) to meet the growth funding requirements. As on December 31, 2019, 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 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 nine-month period that ended on December 31, 2019, UMIL, on a consolidated basis, reported a profit after tax (PAT) of Rs. 32 crore on an operating income (OI) of Rs. 394.6 crore, as against a PAT of Rs. 31.5 crore on an OI of Rs. 422.9 crore for the nine-month period that ended on December 31, 2018.

Key financial indicators (audited, consolidated)

Consolidated	FY2018	FY2019
Operating Income (Rs. crore)	594.0	611.9
PAT (Rs. crore)*	54.1	61.4
OPBDIT/OI (%)	28.7%	27.0%
RoCE (%)	19.9%	19.8%
Total Outside Liabilities/Tangible Net Worth (times)	0.6	0.5
Total Debt/OPBDIT (times)	0.5	0.5
Interest Coverage (times)	18.6	15.0
DSCR	2.6	2.1

**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 (FY2020) Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)*	Date & Rating			Chronology of Rating History for the Past 3 Years: Date & Rating in FY2019		Date & Rating in FY2018			Date & Rating in FY2017
					13-Mar-2020	05-Nov-2019	16-Sep-2019	01-Mar-2019	31-Jan-2019	21-Dec-2017	09-Nov-2017	11-Apr-2017	20-Apr-2016
1	Term Loan	Long-term	102.6	56.89	[ICRA]A+ (Stable)	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- &	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)
2	Fund-based Facility	Long-term	75.0	-	[ICRA]A+ (Stable)	[ICRA]AA- (Negative)	[ICRA]AA- (Negative)	[ICRA]AA- (Stable)	[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+	[ICRA]A1+	[ICRA]A1+ &	[ICRA]A1+	[ICRA]A1+

**As on December 31, 2019; &: 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	9.42%	Jun-22	37.0	[ICRA]A+ (Stable)
-	Term Loan 2	Oct-16	9.85%	Jun-21	21.1	[ICRA]A+ (Stable)
-	Term Loan 3	Oct-19	9.42%	FY2024	44.5	[ICRA]A+ (Stable)
-	Fund-based Facility	-	-	-	75.0	[ICRA]A+ (Stable)
-	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 15, 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	45%	Equity Method
Scrabble Audio Visual Equipment Trading LLC (w.e.f. November 25, 2018)	49%	Equity Method

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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.

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