September 04, 2020

UFO Moviez India Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Loans	102.6	97.3	[ICRA]A+ (Stable); reaffirmed
Long-term, Fund-based Facilities	75.0	75.0	[ICRA]A+ (Stable); reaffirmed
Short-term, Non-fund Based Facilities	10.0	10.0	[ICRA]A1; reaffirmed
Total	**187.6**	**182.3**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation factors in the strong financial risk profile of UFO Moviez India Limited (UMIL) as reflected by its adequate liquidity position, low leverage and comfortable debt coverage indicators. As on June 30, 2020, UMIL (consolidated) had unencumbered cash and bank balance as well as liquid investments of Rs. 145.8 crore, against a gross debt (excluding lease liabilities) of Rs. 120.8 crore.

The rating continues to factor in the well-established position of UMIL 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.

ICRA notes the significant disruptions to UMIL's operations due to the Covid-19 pandemic and the extended closure of cinema halls. Post gradual shutdown of theatres in India with effect from March 11, 2020, UMIL's operations have been significantly impacted, with nil revenues. The Rs. 17.8-crore revenues reported in Q1 FY2021 were primarily from the sale of digital equipment in the Middle East. Due to YoY decline of 86% in revenues in Q1 FY2021, UMIL (consolidated) reported a net loss of Rs. 33.2 crore. As the theatres in India are yet to open, the company will continue to witness almost nil revenues. However, the company has undertaken several cost rationalisation measures, which include among others, ~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. Even after the theatres open up, the ramp up in revenues will be only gradual as footfalls may take time to ramp up amid the ongoing virus scare. UMIL's earnings are thus expected to be adversely impacted in FY2021, as corporates (across key sectors) are expected 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, poses 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.

The rating is constrained by the limited tenure of D-cinema virtual print fee (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 operating profit margins (OPM). Any material change in the terms of the VPF for D-Cinema or E-Cinema (Bollywood producers) is a key rating monitorable. 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.

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.

The Stable outlook reflects ICRA's expectations that UMIL will continue to maintain its strong credit profile and adequate liquidity position despite the disruptions to its operations due to the pandemic

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 the country as on June 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 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 (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 declined by ~35% mainly on account of the decline in the Central Government's revenues (which witnessed a YoY decline of 77%). In addition, the gradual shutdown of theatres with effect from March 11, 2020 also impacted the company's advertisement revenues.

Strong financial profile as reflected by comfortable capital structure and debt coverage indicators 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 March 31, 2020, UMIL (consolidated) had a robust capital structure with total outside liabilities / tangible net worth (TOL/TNW) of 0.6 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 11.7 times in FY2020. As on June 30, 2020, UMIL (consolidated) had unencumbered cash and bank balance as well as liquid investments of Rs. 145.8 crore, against a gross debt (excluding lease liabilities) of Rs. 120.8 crore.

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 Covid-19 pandemic – ICRA notes the significant disruptions to UMIL's operations due to the Covid-19 pandemic and the extended closure of cinema halls. Post gradual shutdown of theatres in India with effect from March 11, 2020, UMIL's operations have been significantly impacted, with nil revenues.

The Rs. 17.8-crore revenues reported in Q1 FY2021 were primarily from sale of digital equipment in the Middle East. Due to YoY decline of 86% in revenues in Q1 FY2021, UMIL (consolidated) reported a net loss of Rs. 33.2 crore. As the theatres in India are yet to open, the company will continue to witness almost nil revenues. However, the company has undertaken several cost rationalisation measures, which include among others, ~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. Even post the theatres open up, the ramp up in revenues for UMIL will be only gradual as footfalls may take time to ramp up amid the ongoing scare. UMIL's earnings are thus expected to be adversely impacted in FY2021, as corporates (across key sectors) are expected 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, poses 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 the share price of the company – The share price of the company has declined significantly in the last 12 months, resulting in reduced financial flexibility. ICRA notes the high dividend pay-out (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 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 from FY2016 onwards, 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. As on June 30, 2020, UMIL (consolidated) had total cash and bank balance and liquid investments of Rs. 145.8 crore, against gross debt (excluding lease liabilities) of Rs. 120.8 crore. It had also sought moratorium on all its facilities from March 01, 2020 till August 31, 2020. Overall, UMIL (consolidated) has long-term debt repayment of Rs. 20.9 crore in FY2021. The company also had unused working capital facilities of Rs. 25.1 crore as on June 30, 2020. The company has also deferred its capex plans in the current year.

Rating sensitivities

Positive triggers: An upgrade is unlikely in the near term. However, 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, while maintaining its strong credit profile.

Negative triggers: UMIL's rating 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 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 results in a deterioration in its credit metrics. Any further moderation in the company's liquidity position on account of stretched working capital cycle or 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, 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; 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 June 30, 2020, while the promoters held 30.53% 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).

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	Amount Outstanding	Date & Rating	Date & Rating in FY2020			Date & Rating in FY2019		Date & Rating in FY2018		
			(Rs. crore)	(Rs. crore)*	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	97.3	79.0	[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+ (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+

**As on June 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+ (Stable)
-	Term Loan 2	Oct-16	9.70%	Jun-21	15.10	[ICRA]A+ (Stable)
-	Term Loan 3	Oct-19	9.30%	FY2024	44.50	[ICRA]A+ (Stable)
-	Term Loan 4	Jun-17	9.85%	Dec-20	1.87	[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 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

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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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