"Prime Focus Limited Q4 FY17 Earnings Conference Call"

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Moderator: Good day ladies and gentlemen and welcome to the Q4 FY17 Earnings Conference Call of Prime Focus Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal the operator by pressing "*"then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Nisha Kakran from Four-S Services. Thank you and over to you Madam!

Nisha Kakran: Hi good afternoon everyone and welcome to the Q4 & FY17 earnings call of Prime Focus Limited. We have from Prime Focus Mr. Namit Malhotra, Executive Chairman and Group CEO, Mr. Ramki, Managing Director Prime Focus Limited and Founder and CEO Prime Focus Technologies and Mr. Vikas Rathee, Group CFO. We will start the conference with opening remarks from the management after which we will open the floor for questions. I will now handover the call to Namit for his opening remarks.

Namit Malhotra: Thank you Nisha. Good afternoon everyone and a warm welcome. I would like to start the call with some introductory remarks and update everybody on the call about our creative services business following which Ramki will brief you on the Prime Focus Technologies side and Vikas would take you through overall financials.

We are happy to report that FY17 has been a year of strong performance for Prime Focus Limited in which we have delivered results that are well above our set targets. We have achieved double-digit growth in revenues with margins crossing the target metric of 20%. In fact, it is a great feeling to be ending the year on a high note with the March quarter being the best reported quarter in our group's history and knowing that all our businesses are on a sustainable growth curve. On the creative side in FY17, we worked on some of the Hollywood's biggest blockbusters such as Beauty and the Beast, one of the highest grosser so far, The Fate of the Furious another billion dollar franchise, Fantastic Beasts and films such as Wonder Woman that are about to release next week. Similarly on the Indian film side we bagged some biggest films such as Dangal, Raees, to name a few. Apart from films like Beauty and the Beast and Fast & Furious, which I just mentioned we delivered great hits like King Kong, Great Wall and currently in the pipeline we have films such as Transformers, Pacific Rim, Justice League, Dunkirk, The Mummy and Geostorm, etc. On India front, in our film and media services, we delivered projects like Raees, Kaabil, Ok Jaanu, Meri Pyari Bindu, Hindi Medium just to name a few in the quarter and we continued to have a robust pipeline with films like Padmavati, Mom, Robo 2, Bang Bang, Reloaded, etc. With all three businesses that is our Creative, Tech/Tech Enabled services and India FMS business poised to a stellar growth backed by cutting edge technology platform. We believe that we have been able to create higher scale and buildup a rather robust order book of about $450 million and making sure that we can deliver an increasing chunk of this high-end work from our low cost centres across the country.

We enter FY18 on a rather positive note and with a stronger order book ever in our past. We are rather confident again in delivering accelerated growth in our revenues and substantial increase in our margin going forward. We would also like to thank our customers for entrusting us with some of the best and biggest projects of FY16-17, our employees and management for successfully completing the global integration process leading to margin expansion and other stakeholders that is our investors and lenders for the belief in PFL's strong growth story. I would like to now handover the call to Ramki for his comments on the PFT side.

Ramki S: Thank you Namit and a very good afternoon to everyone. Prime Focus Technologies delivered a topline of about Rs.341 Crores in FY17 and our EBITDA Margin remained at the same range as last year, which is 26% to 27% in spite of increasing our ongoing investments towards business development and sales and marketing expenses internationally. So our SG&A went up by 2% but we still delivered EBITDA margin of the same levels as last year, clearly demonstrating the efficiencies that the business is gaining on the back of continued increased technology mix in the product mix. Our annuity revenues continues to be healthier, at about 72% of our revenues and international markets contribute about 34% of our revenue while India contributes about 66% of our revenue. So the standard metrics that we publish every quarter has been very steady and that augurs very well for the business. The growth is coming from increased traction for our businesses starting to happen in the United States, more particularly North America with wins that we have announced with Turner, Complex Networks, First Television etc. We also saw the brand services business nearly doubled its revenue Y-o-Y, we have over 216 clients in that business that is South Asia focus business, and we feel very well about that business. Likewise content localization has been a fast growing business for us on the back of the OTT and a digital growth that we have seen has created overall demand more specifically on the localization business for us as well. If you really look at it on the product side we probably have the best set of products available ever in the company's history, we launched the DAX Production Cloud, which is really a next generation product for the production industry and bringing in the best of DAX, which is actually used by over 85% of scripted television series in Hollywood. Again this is the product line that is already used by industry majors like 20th Century Fox Television, Warner Brothers, Television Studios CBS and Lionsgate to name a few and we have now launched the next generation product for the same. We also launched a brand new product called "Create" in-line with our one software vision of extending our media ERP by really helping manage the content supply chain right from the script all the way to post production. This is a mobile-first endeavor, fairly revolutionary in the way we have got the entire supply chain right from script developers, screenplay writers and the entire creative community, the supply chain that really supports the casts, the set designers, costume designers the entire community that is involved in the production of the content today they are all interacting and collaborating on that one single mobile app called Create. It is a brand new offering and we are quite excited with what it holds for the future. We made some very interesting product announcements in the IMF area, which is an upcoming new standard in the media and entertainment industry. We announced support for the standard truly a world first where we have a cloud based IMF player, which is very well received at the NAB trade show that we go to every year in Las Vegas. I am happy to also report to you that we now have attained the status of being a Netflix preferred vendor that extends our rich digital media services bouquet of being able to cater to our clients, digitally preparing content and packaging and delivering content through the OTT platforms and in this case more specifically the Netflix and its popularity worldwide. We continued to invest in our sales teams, we made some significant announcements about key staff that we have added to the sales team in North America, we feel confident that these investments would augur very well as we go forward. With that I would like to handover to Vikas for him to take you through all the financial highlights, Vikas!

Vikas Rathee: Thank you Ramki and thanks to all the participants for making to the call today and it is a busy day with lot of announcements and analyst calls. Before I start I just wanted to go back to about three years ago when we started this journey, we had announced a couple of transactions as we began to consolidate our presence internationally and domestically. Some of you kind of knew the company then and we thank you for being witness to the journey, but just few metrics to see where we were at the end of FY14. Three years back we were Rs. 800 odd Crores company on the topline, while today we are close to Rs. 2,200 Crores. About 4,000 people have gone to 9,000 plus. Our order book almost gone up four-and-a-half to five times to more than $450 million. It has been incredible journey and it is just the beginning of what we expect to deliver in FY18 and then going forward.

With that coming to numbers, consolidated income for the year increased about 13% from last year to exceed Rs.2,150 Crores against the guidance we gave of about Rs. 2,000 Crores last year. EBITDA for the year has hit Rs.500 Crores, it is up 50% approximately and margins are about 23% against the guidance we have given of about 20% for this year, so we are very happy with the performance. I want to thank the operating management and the staff for their efforts to deliver this performance. A big part of this has come on the back of successful integration and the globalization efforts that we have executed both across our Creative Services Business and the Technology Services Business. There is an ESOP expense for the first time in PFL’s history of about Rs.26 Crores, which has been heightened frankly by the fact that we adopted Ind-AS for this year. This is the first full year of Ind-AS financials and there is a considerable amount of work that has gone in that, but we are happy and it aligns our operations across geographies. There is also a non-operating foreign exchange loss of around Rs.41 Crores, which is due to balance sheet translations across our group companies and primarily comes from our UK entities on the back of the Brexit as the pound devalued significantly during the course of this year. PBT before exceptional items is of around Rs.52 Crores compared to loss on the PBT level last year. PAT post minority interest is of about Rs.127 Crores.

Cash PAT, a metric that we look at, which is PAT plus depreciation is at about Rs.380 Crores for the year. So this has been a good year, but it is just a start of what we think the business can deliver on an operating and financial perspective. In Q4 the topline increased about 40% year-on-year to reach over Rs.650 Crores, EBITDA for the quarter is up almost 100% to reach about Rs.185 Crores with a margin of 27%. PBT is at ~ Rs.50 Crores and a PAT is ~ Rs.40 Crores for the quarter. Cash PAT is about Rs.90 Crores for the quarter resulting in cash profit margin of 13.5%. A big chunk of this improved annual performance has come through in the last two quarters where impact of the backward integration in our creative services (visual effects business) into India has really taken shape. So, with continued momentum on this front and a strong order-book of projects, we are very optimistic about the performance going forward.

Coming to the segment wise breakup, Creative Services revenue up about 17% year-on-year to exceed about Rs.1,650 Crores with an EBITDA of Rs.350 Crores and a margin exceeding 20%. Tech and Tech Enabled Services had a topline of about Rs.340 Crores and EBITDA of Rs.90 Crores. Our Indian FMS business was ~Rs.155 Crores and an EBITDA margin of 34%. Now just to remind you all again our financials are now on Ind-AS basis, so we have taken hits for the most part from conversion from Indian GAAP to Ind-AS. Our Creative and Tech Enabled businesses together contribute over 93% of consolidated revenues for the year and about 95% for the quarter. Moving on to the quarterly segmental performance, Creative Services was about Rs.540 Crores of topline with an EBITDA margin of over 25%. Tech services revenue was about Rs.87 Crores and a margin of about 28%. India FMS business revenue was ~Rs.35 Crores. Consolidated gross debt for the group as of the end of the fiscal 2017 was a bit over Rs.1,400 Crores and net debt of approx. Rs.1,250 Crores with cash in hand of ~Rs.170 Crores. The biggest part of the impact on the Ind-AS came on the balance sheet side, and on a like-to-like comparison from last year there is a debt reduction of ~Rs.200 Crores during this fiscal year. Consequently as the debt has come down and EBITDA has grown up strongly the net debt to EBITDA ratio is now down at ~2.5x compared to over 4x a year ago, and we expect to reduce that even more over the fiscal 2018. Debtor's days is ~45 days for the consolidated group which has continued to come down for the group over the last couple of years. With this I would like to thank you all for participating in the call and we would open the line for questions.

Moderator: Thank you very much. We will now begin with a question and answer session. The first question is from the line of Salil Sharma from Kapoor Sharma & Company. Please go ahead.

Salil Sharma: My first question is personal cost is now down to 57.5% of the sales, is this ratio sustainable and could it even come down?

Vikas Rathee: The number has continued to creep down Q-o-Q and even though there is some seasonality in a business, this ratio continues to come down. The personal cost is lower than what we frankly anticipated at the beginning of the year, but if you look on a going forward basis for the next 12 months you should continue to see this to trend down. You might have a little bit of volatility in the quarters, but it is not just sustainable but I think we can reduce it even further.

Salil Sharma: How much of the debt we could refinance during the year from higher cost to lower, net debt now is around Rs.1,255 Crores and how much of it were we able to refinance during the year.

Vikas Rathee: We consolidated bunch of our debt overseas with a group of four European banks that is at about 4.5% interest cost which actually helped us to reduce some of the higher interest domestic debt in India. On the India side also we have consolidated our banking facilities primarily with one bank, that is like a seven-year facility for the most part and it gives us significant flexibility. We obviously expect to pay that down much faster, but there is not really much in the way of refinancing that we are looking to do this year. What you would see is us reducing the debt down from operational sources. I think some of this confusion probably comes from the fact that on an annual basis we renew the Board and Shareholders resolutions in relation to be able to raise money through QIP or a debt or NCD's perspective, this is a regular feature that we do on annual basis. We had similar question last year when we did it. You have not seen us raise any equity or debt in the public markets in the last 12 months, given the way the business is performing, we have currently no need or any reason as of now to go and raise capital either on the equity side or on the debenture side for this year.

Salil Sharma: I was reading in the notices to the stock exchange that there are certain inconclusive decisions because of which the meeting was adjourned, could we have an insight into that?

Vikas Rathee: Yes, this was the first year of transformation from Indian GAAP to Ind-AS. There were other detailed conversations as a part of board for all the impacts of Ind-AS across all the group companies, which led to meeting getting fairly late, so we adjourned it till the next day, so there was nothing out of the ordinary beyond that. We obviously would like to get these things done ordinarily and in time. I think it just took longer on some of the analysis and debate and we reconvened in the next day afternoon and got it done.

Salil Sharma: Nothing unusual?

Vikas Rathee: Nothing at all Sir! We do apologize that we had to kind of do it that way, but it got rather late, so we felt that we should reconvene.

Salil Sharma: The last one is that how much of Double Negative work has been able to outsource to India at the moment like in terms of percentage or ballpark?

Namit: We do not really look at percentage allocations, because we are looking at a fully integrated play now. We have close to 2,500 people on Double Negative side there are about 900 people in India at this point, so that is a formidable number in relationship to the overall capacity. So just on the sheer head count you could say between 20% and 30%, because of where the head count stacks up today.

Salil Sharma: Thank You.

Moderator: The next question is from the line of Abhinav Kalra from Capital Finvest Advisors. Please go ahead.

Abhinav Kalra: My question is on the status of the digital domain stake sale and have we totally monetized it?

Vikas Rathee: Yes. If you remember from quite some time back there were two pieces of the transaction. In the first part of the transaction we got stock worth about $30 million. We have liquidated that and used that towards debt reduction. We have grown significantly in the last 12 months and you would see that we really have not added debt to be able to finance some of that growth.

Abhinav Kalra: Thank you.

Moderator: Thank you. The next question is from the line of Jatin Jain. Please go ahead.

Jatin Jain: Can I get some sense on your capex for FY18?

Vikas Rathee: I will give you a range to what we anticipate, a big chunk of this is growth based and so as we see the order book coming and what we need to deliver it. As we continue to grow the backend on the India side, we have very closely monitored our capex. For FY18, as a group we are targeting a capex spend between Rs.150 to Rs.160 Crores and we will try and economize on that if we can as we try and consolidate some of the operations. If the growth is significantly stronger than what we currently anticipate, it might be slightly higher, but beyond the maintenance part we look at capex very critically and only spend on the back of committed revenue growth based for the most part.

Jatin Jain: My query comes because historically I have seen that we obviously being a growth company, there is a capex requirement, but going forward once we are entering into the next trajectory I just wanted to get some more sense in terms of the profitability getting converted to actual cash because historically the capex has been very high, so could you just give some idea in terms of what is the plan in terms of getting these numbers translated into cash and also what is the kind of capex, which you will do majorly, is it into equipments or is it mainly into intangibles?

Vikas Rathee: Let me just try and answer the second question first. In terms of the breakup between tangible and intangible even for the current year, the tangible capex was close to Rs.160 Crores to Rs.165 Crores which is primarily computer equipment, storage, workstations etc. We have increased our workforce just in the last 12 months by close to 2,500 people, so if you add those people obviously there is some facility build out, also workstations, network, and all that stuff that comes in and a bunch of that is one time as you scale. On the intangible side we are a technology heavy company and lot of the technology that we are using is not something that is available off the shelf. So there is significant effort in developing IP that is being done in-house both at the Double Negative as well as on the Prime Focus Technologies side of it. The IP that we have provides us the competitive edge going forward. That number was around Rs.50 odd Crores for the year and again this will go up and down to certain extent based on projects that we have, that we are looking to deliver, which gives you a sense of tangible versus intangible. Our intangible is less about buying other people's IT and more about internally developing it.

Jatin Jain: My next question will be on the interest cost, so out of the total cost, which you have booked for this quarter how much of that is attributed to the refinancing, one time refinancing cost for March 2017?

Vikas Rathee: So there are a couple of refinancings that we did as a consolidation of domestic and international facilities during the year. So we had about Rs.120 Crores of overall interest and finance charges that we disclosed and also there is an effect of the Ind-AS conversion. So there obviously a lot of charges that typically would not have come in interest, of about Rs.30 Crores that is included, which is either notional / one-time in nature or coming from Ind-AS conversion. To give you an example, when we acquired Double Negative or other entities that we have, there were some deferred payments that were fundamentally part of the transaction to make sure the longer term alignment is there. We have to recognize the present values and then you amortize it through the interest line and also there are a couple of items like that in bank and processing fees, which are one time. I would say interest expense on a regular basis, which you see is about Rs.90 odd Crores and I do not see that increasing going forward, you should expect that to reduce.

Jatin Jain: I would just like to jump back to my capex query. When you said that you are looking at Rs.150 Crores capex, is this kind of capex, which you are required to do every year to sustain the current number or would this Rs.150 Crores be used for next phase of growth. Is this an ongoing capex, which you have to do like maintenance capex. So if you want to maintain your current sales of say Rs.2,000 Crores, would you still be required to do this capex every year?

Vikas Rathee: Not at all like I said FY14 we were Rs.800 Crores Company and today it is Rs.2,200 Crores, so frankly just from that metric alone you will see a big chunk of that is growth. I will break it up for you literally as I anticipate as to what we have of Rs.150 Crores. Our maintenance capex on a consolidated basis across the group is not more than Rs.50 to Rs.65 Crores. Again part of that depends on where the dollar is and where the pound is, so give me that little leeway because some capex is international versus domestic. A big chunk of this is going to be domestic because we are growing maximum in India, as the integration and the off-shoring story works through. So out of the Rs.150 Crores, Rs.60 Crores is maintenance, which is what you would see on an ongoing basis if the revenues, I would not say flat, but if they grow at even 5% odd that is the kind of number you would see us spending.

Jatin Jain: So what is the revenue you are targeting with this incremental capex if you could share that?

Vikas Rathee: So when I do capex, it is not just for one year forward, for example if I add another facility in India, which might potentially house say another 1,000 to 1500 people and we have frankly double shift system for most of the staff here, that can sustain a growth over the next frankly two to three years before we get to the next step level of growth. So, on FY18 perspective some of this capex will contribute to the growth. We are anticipating a revenue growth north of 10% and hopefully it is higher and you should expect our EBITDA to grow in 20% and 25% range.

Jatin Jain: My last question would be any plans to demerge Prime Focus Technologies?

Vikas Rathee: We have had this question in the past. We said that our Technology business and Creative services together contribute about 93% to 95% of the overall business and they are both very critical pieces of the entire picture. As management and as a board of the company we evaluate all kinds of options on a fairly regular basis to unlock value. We believe the company today is significantly undervalued and we will evaluate any and all options to see how we can reflect better value for all our stakeholders including you all shareholders out there.

Jatin Jain: Thank you so much for answering my queries. All the best.

Moderator: Thank you. The next question is from the line of Jaineel Jhaveri from J&J Holdings. Please go ahead.

Jaineel Jhaveri: I just wanted to know from Ramki if you could give us an update on Prime Focus Technologies and how it is doing and a little bit more about the strategy like you spoke about in the last call of delivering smaller solutions as opposed to or targeting niche areas to get more customers, so if you could just give us an update of how that is working out?

Ramki S: The strategy is something that we are continuing, if you look at some of the product announcements that we made more recently as well, those are all directionally giving ourselves enough standalone smaller products to take to customers. Promo operations is a module that we announced about a year ago and six months back we started to get customers. That is getting significant traction, this goes into marketing departments of our customers, at a very simple level the tool brings in automation in the process of versioning of the promos. So that is one good example, today we already have three customers for that product and we already have six or seven proof of concepts that are going in the US at this point in time. Again in the process of distributing content globally, there are specific activities that are done in order to prepare the content for distribution and therein again we have a bunch of innovations, we carved out a module called Mastering Automation. DAX Production Cloud is a standalone module just targeting production customers. So if you really look at it, we are making our products more relevant to address these silos that exist within the customers and equally as we do that one other thing we also realized is customers are also slowly, but steadily buying in the concept of one software. So we are doing more of the smaller ones and continuing to keep our vision intact in terms of the benefits of that one software and encouraging our customers to focus on not just what the cost of the software is that they are buying, but keep the focus on total cost of operations. Given all the automation that the media ERP software is bringing in, we are pretty much letting our customers know that we will reduce their cost of operations and bring in agility like no other while obviously the cost of the CLEAR™ software is going to be high, but we will bring down their overall cost of operations better than their next best alternatives that are available. So if you look at all the innovations that we brought in over the last several years that is one area where we delivered very well.

Jaineel Jhaveri: What exactly if I were to ask this question in a different way in terms of numbers like are you seeing the same clients give you more business or are you seeing bigger clients, newer clients just coming up with more business, are you seeing any kind of traction in terms of growth because last year we just had about 13% or 14% kind of growth. So I am just trying to understand since you are such a small product company and in a very good space, when do you see that growth number actually ramping up?

Ramki S: If you really look at it, we started to make sales and marketing investments really only in the last six to nine months and clearly we got to increase our reach, with our first equity cheque coming in about six months ago. As we do that, the number of conversations are increasing and customers are feeling more comfortable with what we have. So I would say that you will see this turnaround with higher adoption of our product line and consequently faster growth over the 12 to 24 months timeline.

Jaineel Jhaveri: My next question is regarding ESOP, so what kind of expense do we expect to have every year for ESOP?

Vikas Rathee: I will let Namit come in on the ESOP perspective, this is the first time in the history of Prime Focus Limited as a public company that ESOP were issued, so I will let him answer.

Namit Malhotra: This was something that frankly was contemplated for a long time and we finally rolled it out to really reward the whole bunch of people for their legacy and service to the company in building it up. The future path for most of this ESOP led allocation or dilution as a consequences is primarily driven by the outcome in terms of the value we create either at the PFT level, which already has its own ESOP pool or at the Prime Focus World level, which again has its own ESOP pool. So this was to try and make sure that all the contributors of key leaderships from the Prime Focus Limited side saw something play out for them, saw their legacy of what they have done.

Jaineel Jhaveri: This year it was Rs.25 Crores should I expect a higher number like it was Rs.8 Crores or Rs.9 Crores in the last quarter is that supposed to be the run rate going forward or you do not expect such a high number every year?

Vikas Rathee: A big chunk of that has come because under the Ind-AS we have to look at ESOPs differently unlike Indian GAAP where it was the intrinsic value method in this we have to do it in a Black-Scholes. As we booked on it, the Black-Scholes option evaluation gives a dramatically higher charge given we had a fairly volatile share price, so the charge for FY18 would be higher on an overall perspective probably in the range of Rs.45 to Rs.50 Crores.

Jaineel Jhaveri: Another question was the second tranche of the digital domain transaction when is that supposed to be done, this is about $25 million still remaining if I am not mistaken?

Vikas Rathee: It is about in that range between $20 and 25 million. Just to give you a little perspective there were a couple of new investors that came into digital domain i.e. Soft bank and CITIC made investments in Digital Domain. So obviously this transaction has taken a little longer. We are actively in discussions on that and we are hopeful that it gets done in the current quarter. But if I am conservative I will say it is likely in the next three odd months, because we are evaluating the right structure and how it fundamentally works especially with the new shareholders and it is just taking a little longer, so hopefully by the end of June or it might move into July timeframe.

Jaineel Jhaveri: And then we would also sell that I am assuming?

Vikas Rathee: It is a public stock so I would not like to make any specific statements on the disposal except that we would intend to monetize any non-core investments for the best possible value for our stakeholders most efficiently.

Jaineel Jhaveri: I did see those enabling resolutions for dilution of equity and raising of NCDs I guess this is just a suggestion from my side is that since this is done at the holding company level you are probably not going to get very good valuation for your equity especially at the Prime Focus Limited levels, so is there a thought process of doing these dilutions separately on those two companies, so that you get better valuation?

Vikas Rathee: As I mentioned earlier, currently we are just dramatically undervalued in relation to what we are delivering now and more so on the prospects that we have. On the back of a confirmed order book and a business model, which is already proven and dramatically increased margins and you would have noticed that the margin expansion has accelerated just over the last two to three quarters. We are heading above what we even highlighted in the past. So there is definitely a lot of value, which is not being recognized and we will absolutely and regularly do evaluate opportunities to try and unlock that. Let me leave it at that if that is okay.

Jaineel Jhaveri: Last thing in terms of any acquisitions that you are thinking about for the next one-year?

Vikas Rathee: No. I think we have been fairly categorical that there is nothing we have in mind currently and it is almost three years since the Double Negative and RMW transactions.

Jaineel Jhaveri: I just wanted to know nothing has changed?

Vikas Rathee: Nothing has changed, we are delivering on the back of organic expansion and integration going through.

Jaineel Jhaveri: In terms of debt what kind of debt repayment should we expect from internal cash flows this year, so we are starting the year now with Rs.1,250 Crores how much would you be able to get it down to or what would you put as the target?

Vikas Rathee: We absolutely want to bring this number down by another Rs.300+ Crores. In the past, I have mentioned that we believe a sustainable right amount of debt for a company of our nature and a global reach in working capital term is probably in $100 million range. I am saying this from a debt capacity perspective, it might not be drawn that is but having available revolving capacity of working capital. That is where we want to get to, that is the target. Can we achieve that in the next 12 months, I would say on a pure operating cash perspective and using that towards it, it will probably take longer than 12 months but hopefully not dramatically longer than 12-24 months. We will look at what we think we should have at a sustainable level. So we would look to reduce our net debt by another about Rs.500 Crores and I think it is absolutely achievable over the next two years.

Jaineel Jhaveri: So about Rs.250 Crores per year?

Vikas Rathee: On an average basis that is fair.

Jaineel Jhaveri: One other thing I have been noticing there is an increase in the other expense this year. Is there something that is one time or does the other expense actually move in tandem with the growth in the topline, so if you see there is 38% growth in other expenditure and the net sales have grown 40% in this quarter, so are they always going to be?

Vikas Rathee: No, as I said we went through the whole transformation from Indian GAAP to Ind-AS, there is a bunch of stuff that comes in with that. There are certain items that will grow with the amount of work and revenues but equally enough there are a number of items such as facilities costs, broadband and other charges that will go up in a step function once additional new facilities need to be added. So there is a combination of linearity and step changes.

Jaineel Jhaveri: So you were saying it would not move in tandem with the growth in topline?

Vikas Rathee: No. I will tell you what has a high correlation is the personal cost with the revenues and that also is not a direct relationship because most of our personnel that we are adding today are on the domestic side in India. I would say which is a lower cost resource than our employees in the US, UK and Canada. They are starting to deliver work, which is of international quality, so there is obviously a correlation there. I cannot tell you that my revenues will increase and the number of personnel will decrease, so the number of personnel will increase in relation to that. Other expense is not something that directly kind of grows along with the revenues across all sub categories.

Moderator: Thank you. I would request Mr. Jhaveri to come back in the queue for followup question. We will move to our next question, which is from the line of VP Rajesh from Banyan Capital. Please go ahead.

VP Rajesh: My first question and I apologize I joined late, but I was just wondering if you can comment on the growth that you saw in the creative services this quarter and is this sustainable Rs.540 Crores or so.

Vikas Rathee: I think growth is not just sustainable, we expect to be able to accelerate the growth. There is a certain amount of conservatism when you suddenly start doing really, really high end visual effects work on movies such as The Fast and Furious or Star Trek or Jason Bourne or The Mission: Impossible series. There is a hesitation in the initial period of bringing that work, it is not India just but to any new location, it starts low and you saw that probably in the first half of this year and it just accelerates on top of that and that is also visible in the last two quarters. It is not just March, but if you just look at our last six months, it is fundamentally on the back of acceleration of the confidence that we can deliver work out of our local centres, so you should see acceleration on this.

VP Rajesh: That is great and then just on the consolidated P&L you mentioned that there is this exceptional line item, which is there, which is negative Rs.96 Crores for the entire financial year, so could just give some colour on that?

Vikas Rathee: That is the gain that we booked on the monetization of the digital domain stake, our investment that we inherited as part of the Reliance MediaWorks business, so that is a gain on an aggregate basis.

VP Rajesh: Just quickly on the other expenditure line item when you were talking about that the foreign exchange gain is below the EBITDA line items right, so that other expense line item, it is something, which is correlated to personal cost or there is some one off numbers in there that is what I am trying to understand if there is any one off number in that Rs.423 Crores of other expense?

Vikas Rathee: Like I said I was not sure, which presentation Jaineel was looking at, but if FX is out of that. There are a few one-time things that come into it. This fundamentally is new facilities, for example, we expanded into new facilities there will be certain charges in relation to that. You also have legal and professional services, which was significant given couple of things that we did over the last 12 months. We redeemed Macquarie preferred instrument that we had in one of our subsidiaries and so including most such costs legal and professional charges as well as technical charges otherwise that we fundamentally had in relation to that, that go in there. As I mentioned there were two big refinancing's we did during the course of last year, as I said it was more about consolidation of our bank facilities across, some of those charges will come on the bank side, but the legal and some of the other charges will come and hit there. So the legal and professional and expansion, which is one time, also comes into this thing. So there will be some, which is recurring, but there is a portion of that, which is nonrecurring. In terms of the breakup, I do not have it in front of me right now to be honest. I am happy to have a separate conversation in a call and give you that later.

VP Rajesh: Sure I will follow up separately and the last question on the debt side, so my understanding is whenever we monetize the second piece, which you were earlier talking about we were going to pay down debt, so is not it correct to assume that our debt at the end of this financial year is going to be substantially lower because you will have the proceeds from that transaction plus the cash flow from the business, so am I missing something?

Vikas Rathee: No, you are not missing much frankly, at the end of the day cash is fungible. Where we see right now and how we expect to grow, we feel that we can probably grow faster, so on a net-to-net basis money should go towards debt reduction or capacity expansion.

VP Rajesh: Great that is all I have and congrats again.

Moderator: Thank you. The next question is from the line of Apurva Mehta from KSA Shares & Securities. Please go ahead.

Apurva Mehta: Sir just wanted to ask on the Creative side, what type of growth we can expect from there and what type of margins we can expect?

Namit Malhotra: I think all along as you have seen, year-on-year there has been consistent increase in revenue and the margin continues to expand which has really been the focus of our effort in the last couple of years. The impetus primarily has been on margin expansion because we believe that there is significant headroom in that. While there is additional scope for revenue expansion quite comfortably, we recognize that in order to allocate our focus and efforts, we are better off focusing on margins, so obviously for every quarter 10%, 15% increase in top line we like to believe that the margin should increase between 30% to 40%. So that is really the general construct of how we are operating.

Apurva Mehta: Sir that means you are focusing more on utilization level of our people or you are looking at more quality of services, which you are going to give and you can end up with more revenue?

Namit Malhotra: I think it is a combination of both. So historically the fact is that Double Negative as a company was primarily constrained by its own capacity. When we acquired the business revenues were in the £65 to £75 million and it was primarily a UK business with small offsite in Singapore. Since then capacity wise we have almost gone up 2.5x. The maximum expansion of that happened in India, which is how we have tried to focus the business. So as we create more capacity and frankly more profitable capacity, so we are hoping to see that revenue continues to grow steadily and the underlying performance on the EBITDA is significantly ahead of the revenue expansion.

Apurva Mehta: And Sir how do you feel the market is currently, is it on a very good note or is there is huge competition, how do you see that?

Namit Malhotra: The services that we represent clearly is in major demand. We have got a large number of big franchise movies that are doing blockbuster performances. You have seen that even in places like India, VFX heavy movie such as Baahubali has gone ahead and broken all records. Here also same new age companies such as Netflix and Amazon significantly are growing in content and that entire content spend is significantly greater than what television companies have done in the past and a decent chunk of that is coming our way, what we call a TV / Digital business. We have got our largest contract for a show that is on Netflix right now. So we are seeing that good demand continues to be there. We have expanded on to the feature film animation space. So we have signed our first animation film contract with Disney. That is a big step forward in terms of how we are diversifying our service portfolio and building capacity in India. So we are strategically moving forward on the front end as much as we are scaling up on the cost side in India, so that helps create good operating matrix.

Apurva Mehta: Sir Can you throw some light on this animation side. Sir what type of opportunities are there and how is the China venture doing, so can you throw some more colour on that?

Namit Malhotra: Animation is a massive opportunity and historically companies like Disney, Pixar, and DreamWorks, even Illumination, all of the big animation companies. They always believed in doing all their feature films high end animation on their own and Double Negative has obviously now stepped into that arena of trying to deliver that quality of high end animation on the back of our capabilities. So we are doing our first project in that construct obviously a lot will change and a lot more positives impacts will come into visibility as we go through delivering that and the world recognizes the quality and scope of what we can do. That is certainly growing pretty well. As far as China is concerned, we continue to be on the lookout for appropriate projects and appropriate budgets that can actually come our way and so far our hands have been full doing the Hollywood work, so we do believe that this year we will be focusing a lot harder and keenly on China as well to add additional revenue capacity.

Apurva Mehta: Sir what type of order book is in animation right can you just quantify?

Vikas Rathee: What you see a part of this is the one project that Namit mentioned. I cannot give you exact precise number, but to give you a ballpark the number on that particular contract is between $25 and $35 million. Beyond this we also have an exclusive contract with an Elisabeth Murdoch funded Animation Company with a three picture deal on that, which is going to keep our animation team busy for frankly three to five more years after this one gets done. Each of those projects is going to be in the range of $40 to $50 million and that is not included in the order book because the specific contracts for each of the movies are not signed even though we have a three picture exclusive deal.

Apurva Mehta: What will be the run rate for animation if we take from next year and after that what will be the run rate for that?

Namit Malhotra: I do not think we should split, none of our businesses right now frankly are split because we are allocating the same teams and the same overhead and we are not really splitting. That is an animation division and this is the film or it is TV for that matter.

Apurva Mehta: This is the new revenue stream if we add because it was not there?

Namit Malhotra: Exactly. We have just added an additional service line to tell our clients that we can also do this and it is running out of the same core infrastructure and core capabilities of the company.

Apurva Mehta: So on the creative side how much of growth we can expect this year? Can we expect 20% topline growth?

Vikas Rathee: So what I mentioned, is that we should grow north of 10% in topline and north of 20% on EBITDA margin.

Apurva Mehta: But that is on the blended right?

Vikas Rathee: Yes and again today creative service is around 75% to 78% of the overall business. I would not say creative services would not grow at that level; it is driving the big chunk of the growth.

Apurva Mehta: Thanks a lot and wish you all the best.

Moderator: Thank you. The next question is from the line of Zahara Sheriff from Fedwinteg Knowledge. Please go ahead.

Zahara Sheriff: You are doing really well now, but just wanted to know some of the top risks that you are worrying about, what worries you now?

Namit Malhotra: As a business you are obviously making sure that in the world we live in when you hear the Ransomware attacks and the other content threats that constantly come obviously that is a big concern. Frankly that is what Ramki and I can squarely establish as our number one concern at all times to make sure that the material and the content of our customers is secure and safe as a number one priority. At this point having now gone through call it hardship of the last two to five years of seeing the establishment of a brand, the volatility that comes on the back of not having the Tier 1 creditability, the financial balance sheet strength, frankly we have tackled all those issues reasonably well to actually get to a place where hopefully those issues are behind us and we are much more enthused about the prospects ahead, so as far as content security, I guess the stability of the world and the interest of people wanting to watch big movies in cinemas I guess I do not think anything else at this point bothers us.

Zahara Sheriff: And could you just talk a little bit about what is the kind of competition or competitive intensity that you are looking at in all of your segments?

Namit Malhotra: As an integrated player over the years, we have always established the fact that we are universal competitor across various sectors and sub sectors of what we do, so as a universal competitor it is hard to actually pin down any one particular company.

Zahara Sheriff: No, I am not talking about an individual company, but I am just saying the lay of the land like when you are pitching for projects what are you coming up against or the technology side especially and even others as well?

Namit Malhotra: It depends on the kind of job that we are talking about. Obviously, if you are specifically talking about visual effects and animation or TV or 3D or virtual reality or cloud based services or content management depending on the specific area that we are pitching on. There are obviously competitive dynamics that tend to play at those levels, but the levels of integrating and providing more one stop solution, that we pull up actually helps our case greater than some of our competitors can. However, overall it is clearly a global industry and our competitive landscape is companies in America, UK, Canada, and Australia, in the mix depending on the kind of project and size with multiple companies across all these various geographies, which have their own specific strengths and weaknesses.

Zahara Sheriff: Right, but just in terms of pricing behaviour, are you seeing any?

Namit Malhotra: Most of the work we do is an odd predicament because L1 is not the basis of our work. It is not like the lowest bid against the job. In fact it is never that way. Since it is more B2B, so it is more about project mapping when you look at, depending on the kind of project, the kind of team you could put together, the management of that project, or the management of those teams with those particular clients and their historic relationships. The whole package with the financial proposition really becomes an outcome of a sale, so it is not pricing led. It is much more strategic in terms of trying to make sure that you are right sizing. It is like a pitch based business where you got to make sure that you have got to get your pitch right, the teams that they work with, deliver the messaging correctly, and improve all the aspects of ensuring that they have belief in the executional capabilities and the scale of what we will undertake to be able to deliver that in a timely manner. I think that is how typically we end up competing and that is why it is a bit more complex and I wish I had an easier answer to give you, but it tends to be much more holistic and pricing is just one of the levers. Sale is the process not a project where you just go and sign on a bid and you get a purchase order.

Zahara Sheriff: And how vulnerable is the sale process to the personnel in the respective studios or attrition there is that function?

Namit Malhotra: I think when I give you an example of project mapping, you have got a scenario, in the studio it is filmmakers that includes film directors, producers, sometimes even writers, and all the way down to depending on the technical department or the choice of a visual effects supervisor and visual effects producer. There is a whole group of people that come together because we are the single largest line item on a budget today. So it is a consideration that few people have to make together and hence we have to make sure that we are lining up the right teams internally, the right kind of work and the right examples of work that need to be shown because it is not just about having a particular person they want to know as a company you have specific capabilities and credentials in certain kinds of work that have to be done and so it is an overall pitch. It is an overall proposition. When you are trying to do something brand new and if I have to tell you that the stickiness in executing Fantastic Beasts last year, which was called the first film in this new franchise, now they do two, three, four, five, much like a Harry Porter or Transformers, we will automatically get a major role much more naturally because now it is not going to be starting from ground zero and that is going to be logical transition because now they already know and its proven. So when you are absolutely doing the first one, which is brand new, you are going to really get on board and really have this detailed pitch process that you have to get right, but once you have already signed onto the film, then it is more of how much can you do at what price and in the time that they have rather than do you qualify on the metrics of approval.

Zahara Sheriff: Thank you so much.

Moderator: Thank you. The next question is a followup from the line of Salil Sharma from Kapoor Sharma & Company. Please go ahead.

Salil Sharma: I wanted to know one what is the capacity utilization in terms of employees we have is there any bench out there or are they being utilized all through the year?

Vikas Rathee: Internationally where we have the highest cost, our utilization has been and continues to be north of 95% on the net of holidays and sick leaves that are typically there, we keep it very, very tight. On the domestic side again the utilizations have always been 85% plus. There is a certain level of allowance for trained people as Namit mentioned and I would say skill enhancement that we continue to do as we pull higher end visual effects from overseas here and that tends to pull the effective utilization back. Today, if you ask me, there is additional execution capacity out of India and the revenues that we have is just frankly limited as previously somebody was asking competition is limited more by the amount of execution capacity we have to take on projects. There is quite a bigger, much bigger market out there. We are only about 10% of the market today, so the opportunity is great, in terms of maximizing the existing capacity by increasing the efficiency of the local artists in India that is where the maximum amount of effective utilization enhancement opportunity is.

Salil Sharma: Namit Sir spoke about the cyber security risk, what is the steps we have taken to kind of preempt anything like that from happening, which can be disastrous for a company like us?

Vikas Rathee: Yes you are right. We have taken steps on our side and the MPAA mandates certain best practices and so do the leading studios. So there are two parts of this on the creative side. We have obviously our own security software. We never keep all images or movies in one place, they all get massively encrypted, broken up and put in different places so typically we do not have completed content or movies on our system. We work on a shot by shot or a sequence of shots perspective, which come in from the client and then we send the completed shots back. Our facilities are MPAA certified where they come and do security audits and stuff. The largest studios like Disney, FOX and Warner Brothers also come in and do their own security audits. So that is the process that we follow. Everybody feels that we are the most secured and we continue to update and upgrade our security protocols, but whole industry as such we are very evened out both from protecting ourselves from hackers on one and two, similar to people having safety boxes or safe deposit boxes across multiple banks the customer content gets encrypted and stored across multiple locations. So you just do not keep that content on one place. On the PFT or technical services part of the business that security is similarly extremely important. PFT is probably one of the only companies, which is SOC2 compliant, which certifies the heightened levels of security protocols, as well as ISO2001 certified if I am not mistaken. I am not a technical person. So security is at the heart of what we do. That is why our customers entrust us with their valuable content. But we have to continue to enhance the security level, that is all I can say, we feel that we have taken adequate measures to date, but you can never rest on way you are, you continue to add to that and we take also cyber insurance today, to protect the company from a financial exposure.

Salil Sharma: But there is no vendor who takes care of any sudden attacks or something like that like may be BODDS or something like that which has happened to Netflix and Amazon and that is not possible here?

Vikas Rathee: Like I said, I am not a technical expert, when we say we feel we are secured, we are actually part of the process of checking that includes experiments and I would say controlled hacking attacks from outside to make sure that we are fundamentally able to do that. I am not a technical person, but part of the stimulations we run into make sure the security continues to be as we do work with vendors to create for the task and see how we are able to protect ourselves and defend again. So that is part of the process.

Salil Sharma: Then coming to the Indian Company there has been a decline in the sales and the loss has run up to around Rs.20 Crores in this quarter if I am correct, so what is the reason for this because one was I kind of understood that once Reliance is merged with us the major competition would be out, so things are not working as per that?

Vikas Rathee: Yes, but it is not the competition part of it. The biggest part of this is that ESOPs were issued by the Indian company, so the entire ESOP expense fundamentally comes and hits the domestic business, of the listed entity on a standalone basis. So all of that Rs.26 Crores plus is there. You are right, there is a slight one-off decline in the business in this particular quarter. Demonetisation has definitely hit the media industry a bit harder than some others. There has been a delay on some of the projects because as part of the demonetisation impacting the box office, a bunch of movies collections are not as rich as you could have expected and that has also led to certain delays on ongoing projects. It is one of our stable business and it is one-off quarterly hiccup if you can say that or by Rs.2 to 3 Crores and it is not an alarming situation. It is definitely not competitive. It is just a few projects getting pushed into the June quarter.

Salil Sharma: We have seen the news reports about Ramayana, is it on the cards or is it a speculation.

Vikas Rathee: That is not the question for the Company to be very frank. I mean Baahubali has done exceptional kind of business. We continue to be do all the mega VFX movies for the Hollywood industry. The Indian market is growing, we as a company are not attached to this particular project as of now.

Salil Sharma: But, Namit in his personal capacity is one of the partners?

Vikas Rathee: I think we have seen his name mentioned. I think it is more in spirit is what I understand, but again I cannot comment on his behalf.

Salil Sharma: To Ramki, PFT is doing work for Netflix. Is that just for the domestic Netflix part or even international?

Vikas Rathee: There seems to be some challenge with Ramki's line. Let me address that. As of now what he was addressing is that we definitely are doing work for them for the India part and it is not just domestic India. We have been looking into the Asia perspective and they are across a lot of countries and we also are having a dialogue with them in relation to the US side.

Salil Sharma: Yes because that business seems to be growing in India even abroad like more people switching away from TV to laptops and handheld instruments. So even Amazon is doing the similar kind of work and some of the Indian companies are also so we would be involved with them also? Would you be pitching for that?

Vikas Rathee: We are working with Amazon as well in India.

Salil Sharma: One of the earlier speaker was talking about demerging PFT but one could even think of demerging PFW and try an American listing so that would yield a better premium there. So is there anything on the word for that?

Vikas Rathee: As I mentioned earlier, we are always looking at various opportunities to kind of unlock value and we have not ignored any option, what you mentioned is a practical alternative that we would naturally evaluate. I really cannot say anything more than that.

Moderator: Thank you. Ladies and gentlemen due to time constraints that was the last question. I now hand the conference over to the management for closing comments.

Vikas Rathee: Thank you so much. We really appreciate you all having the time and patience to participate in the call today. I know there was a lot of competing analyst calls at the same time and we really appreciate you joining us and being patient listeners. We look forward to the next call and continued improved performance and good results. Thank you very much again.

Moderator: Thank you. On behalf of Prime Focus Limited that concludes this conference. Thank you for joining us. You may now disconnect your lines.