



“Prime Focus Limited Q2 FY17 Earnings Conference Call”

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MR. RAMKI SANKARANARAYANAN – MANAGING DIRECTOR, PRIME FOCUS LIMITED AND FOUNDER & CEO - PRIME FOCUS TECHNOLOGIES
MR. VIKAS RATHEE – GROUP CFO, PRIME FOCUS LIMITED

MODERATOR: **MS. NISHA KAKRAN – FOUR-S SERVICES**

Moderator: Ladies and gentlemen, good day and welcome to the Prime Focus Limited Q2 FY17 Earnings Conference Call. 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 an 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. Thank you and over to you, ma'am.

Nisha Kakran: Thank you. Good afternoon everyone and welcome to the Q2 and H1 FY17 earnings call of Prime Focus Limited. We have from Prime Focus, Mr. Namit Malhotra – Executive Chairman and Group CEO, Ramki – Managing Director, Prime Focus Limited and Founder & CEO of Prime Focus Technologies and Mr. Vikas Rathee – Group CFO.

We will start the conference call with opening remarks from the management, after which we will open the floor for questions. I will now hand over the call to Namit for his opening remarks. Namit, over to you.

Namit Malhotra: Thank you, Nisha. Good afternoon everyone and a warm welcome. We are pleased to report a continuing trend of good growth in revenue in an otherwise slow September quarter for the Creative Services revenue. In all the three businesses i.e. Creative Services, Technology and Indian Film and Media Services, we continue to lead from the front cementing our market leadership and are committed to continue innovation and progress. Our Creative Services division delivered steady growth with major Hollywood blockbusters like Inferno, Miss Peregrine's Home for Peculiar Children etc. Our order book grew at a robust pace to reach over \$250 million compared to \$200 odd million in the last quarter with movie additions like Chris Nolan's, Dunkirk, The Mummy Returns, Wonder Woman and Fast 8 to name a few.

Our Strategy of pushing our bundled services in a package tends to ensure that we continue to grow. In India on the Film and Media Services side, we delivered projects like Flying Jatt, Rustom, M.S. Dhoni, Dishoom, and Dear Zindagi amongst others and our pipeline continues to be strong with major marquee projects like Dangal, Raees, Kaabil, and Tubelight among others.

We are also pleased to welcome on board another marquee investor i.e. Ambit Pragma who have invested in Prime Focus Technologies. It further validates opportunities that exist in our various businesses as we continue to embark on our next phase of growth. The quarter was also notable as we made it to the prestigious Fortune India Next 500 list of companies and we are ranked 18th on the list, credible recognition of our future growth potential.

I would like to hand over the call now to Ramki for his comments on Prime Focus Technologies. Thank you.

Ramki Sankaranarayanan: Thank you, Namit and good afternoon to everyone. Prime Focus Technologies has delivered robust growth, about 29% year-on-year in this quarter partially driven by growth in both the international and domestic markets. EBITDA stood at about 28.1% which is maintained in the range of about 25% to 30%. Share of our international revenues is about 34% and the annuity

mix is at a healthy 69%. All of this is being consistent metrics that we have had in the last few quarters.

The CLEAR media ERP SaaS software continues to make strides with several key innovations, which are pretty much the key driver of how we differentiate what we offer to customers. We are quite happy to have received the TV Technology Best of Show award and this is the award that is given out at the International Trade Fair called the IBC in September 2016. This award was for the promo operations module within the broadcast cloud, which is a part of the CLEAR Media ERP suite and that is a pretty noteworthy achievement for the quarter. Apart from this with multiple wins in the quarter, our order book crossed about \$200 million with new client wins as well as extending contracts with the existing customers. Some of the new customers we won are International Cricket Council, Amazon, and Prasara Bharati to name a few.

Packaging and delivery on the back of robust growth of content consumption over internet mobile devices, has been one of the fastest growing component of our services engagement. The International Cricket Council (ICC) has been a significant win on the back of what we do for the Board of Control for Cricket of India and Cricket Australia. We also signed a long term agreement with Amazon for the packaging and delivery for the Amazon video services as part of the Amazon Prime™ membership, something that went live yesterday. We are very honoured to be part of that programme and doing work with Amazon. We also received our first order for processing for Netflix, all of this on top of the work that we do for Hotstar, Voot, and Hooq. So, this pretty much sums up our involvement with platforms that are significant in the OTT (Over The Top) consumption at digital space here in India.

We also secured first round of growth equity from Ambit Pragma just like Namit mentioned at an attractive valuation. We intend to deploy that for our business development, product development and of course sales and marketing in the international markets.

With that, I would like to hand over the call to Vikas, so that he can take you through the financial highlights. Vikas.

Vikas Rathee:

Thanks a lot, Namit and Ramki. Gentlemen, thanks again for joining the call today. We appreciate you taking the time. As we have mentioned clearly in our press release and otherwise, Prime Focus took the step of adopting the Ind-AS standards as of this quarter and obviously this is a significant effort on the back of fairly large changes that, primarily impact our balance sheet as opposed to the operating P&L side of it but it is a very large exercise and so we appreciate your patience. Continuing on the theme from Namit and Ramki, we are very happy to report a good quarter. As Namit mentioned, given the holidays in the US and UK in July & August which has an impact on our revenue recognition, September is usually a slow quarter. But we are very happy that we actually did show good growth during this quarter and deliver revenues in the range of Rs 484 crores.

The EBITDA margin if you look back from the previous year September qtr has gone up significantly, we are up by more than 71% to reach about Rs 91 crores and EBITDA margin is

close to 19%. In terms of couple of other notable items, I would say there is a significant increase in the interest expense owing to the conversion from Indian GAAP to Ind-AS and that primarily comes from the fact that some of our preferred equity investments which are looked at as equity in Indian GAAP have to be accounted as debt with a derivative imbedded in there and that has increased both overall debt levels as well as the interest expense in relation to them. There are changes across multiple sides on this and we will be happy to take anybody through that in detail separately rather than take up too much time on this call.

To give you a sense on overall 6 months perspective, we have delivered north of Rs 1,000 crores of revenue and EBITDA of around close to Rs 195 odd crores, so an EBITDA margin of about 19+ % and given that the first half of the year for us is typically only about 40% of 45% range of delivery for the entire fiscal year, we are well ahead of our target and the guidance we have given in the past i.e. revenues north of Rs 2,200 crores and EBITDA margin north of 20% and so, we are happy about that. We continue to be PAT positive for the first 6 months, it has been aided by gains in relation to the investments we sold earlier.

To give you a little bit color on the key segments, Creative Services even though the revenue only grew about 3% year-on-year, the margin on the EBITDA side grew by 459 basis points and this demonstrates the progress we continue to make in terms of not only growing revenue but at the same time with the addition of more resource in India, we have been able to deliver the revenues at a higher margin YoY. Ramki talked about the technology services business which continues to grow close to around 28%-29% year-on-year and EBITDA margin sustaining at about 28%. The India domestic business continues to be very robust for us, it again grew about 7% for the quarter and the EBITDA margins continue to be extremely strong close to 44%.

In relation to the overall balance sheet, the total debt stands approximately \$220 odd million, just slightly up from where we were in June and that is primarily because of exchange rate differentials and the fact that it treats our preferred investments overseas as well as some of the deferred consideration for some of the acquisitions that basically goes towards debt on the interest expense side as well. So, that increase is primarily on that. We had significant cash on hand as of the end of September over \$16 million and I can tell you that we have continued to pay down more debt since September 30th timeframe.

One thing I would like to also mention is for the first time in our history, Prime Focus Limited issued employee stock options to a broad range of employees across the board - about 1.7 odd crores of shares have been given and as we look forward for significant growth and opportunities, here the company is looking to recognize the employees who have contributed over the years to get to where we are and frankly incentivize performance going forward.

With that, I would like to once again say thank you for you all to join the call and we are happy to open the call for questions.

Moderator:

Thank you very much. We will now begin the question and answer session. We have the first question from the line of Dimple Kotak from SKS Capital. Please go ahead.

- Dimple Kotak:** Sir, I just missed on reason why has debt increased and you mentioned that you have asset compensation and all, so can you just please repeat because I could not get that?
- Vikas Rathee:** The debt has fundamentally gone up because we have preferred equity investors in our overseas subsidiary in the form of Macquarie and AID Capital. Together, they are about \$47-\$50 million investment under Indian GAAP, since these are preferred equity instruments, it was treated as equity earlier. Under Ind-AS in a conversion perspective we have to treat them as debt till such time they are converted to equity. So that has added around \$50 million basically to the debt number that is from earlier days while the core business debt continues to be paid down.
- Moderator:** Thank you. We have the next question from the line of Salil Sharma from Kapur Sharma & Company. Please go ahead.
- Salil Sharma:** My question is regarding the overall turnover, we have included Rs 17 crores which is the other income. This other income is one time income or the recurring one?
- Vikas Rathee:** So, for the most part you should look at that as one time income fundamentally, as we have gone through the process of conversion and everything, as we look at our policies across the board what we obviously have here is we have cleaned up some old creditors and stuff like that where the things are no longer payable. Again, these are smaller pieces of the entire numbers. Some income is in relation to operation, but cannot be considered as operating from our audit perspective and that is why that is coming. So if you ask me, most of it is, one time but the end of the day we do end up having some amounts of other income on a quarterly basis.
- Salil Sharma:** And if we look at the employee cost as including all the technical fees and the technical cost it roughly works out to around 64% on the sales though it is an improvement over the last year same quarter. But do you think this percentage is going to sustain for the long term?
- Vikas Rathee:** Actually sir just to give you a sense as I said earlier, September is kind of slow quarter for our Creative services business where a big chunk of our employee cost comes in which is fundamentally what has been happening. Because of the holidays in the US in late July-early August and in Europe from August perspective, and as lot of our revenue get recognized in relation to percentage of completion and how much work you have done towards that. But what is happening is during the September quarter, there is less revenue recognition while my employee cost remains high because I have to continue to bear that expense. So, frankly the actual improvement in relation to the proportion of employee cost where our revenue is far better than what about the number shows. If you ask me, you should see this number, dip in the December quarter and again in March. So, our aim is to try and bring it down below 60% in the near term.
- Salil Sharma:** So, if you go below 60%, it will have direct impact on the EBITDA margin right?
- Vikas Rathee:** That is correct sir. If you ask me that is the big improvement on the EBITDA margin which we saw even in the Creative services business because of the fact that we are delivering similar or

the high revenue on the back of naturally lower employee cost. September quarter is typically tougher for us and we are pretty happy with the performance the business has delivered in a slow environment, you should see even more significant pick up in December and March.

Salil Sharma: And when do you expect to monetize the Digital Domain transaction?

Vikas Rathee: So there are two pieces to that transaction, The first piece like you said we already consummated that in relation of getting \$30 odd million worth of shares. The second one is in progress, we hope to be able to consummate that before March. As you know that the shares obviously trade in the market, and so this is kind of price sensitive information but we have been progressively looking to monetize that asset from market sales perspective and we have done so and we are already using those proceeds towards debt reduction.

Salil Sharma: I did not get that, sale has already taken place or going to take place?

Vikas Rathee: Like I said, it is price sensitive information relation to the fact that security trades in the market overseas, so all I can say to you is that we continue to constructively monetize that position and using the funds towards debt reduction.

Salil Sharma: That will be 100% sort of debt reduction only, right?

Vikas Rathee: Yeah, the business kind of generates the cash it needs for itself, I never like to say 100%, but between the sufficient cash that we generate from the operations and that, we should see the money going primarily towards debt obligation.

Salil Sharma: And lastly, you just mentioned about Netflix and Amazon, what would be the turnover expectation from these 2 projects.

Ramki Sankaranaryanan: This is Ramki here. Yeah, obviously these are larger engagements and we are quite excited being part of that endeavor.

Salil Sharma: What one can read about Amazon Prime and Netflix, they seem to be coming quite strongly into the market, so are we part of like overall assignment or will it be just a marginal one from their point of view?

Ramki Sankaranaryanan: No, look very clearly as these platforms get extended footprint in India and play in India more seriously, there is a significant amount of content from India that needs to get into the platform and as we have played a role in Hotstar, Voot and Hooq, we are playing a similar role for Amazon and Netflix as well.

Salil Sharma: Sir, I think you mentioned that the PFT growth would be around 30% annually?

Ramki Sankaranaryanan: That is correct.

- Moderator:** Thank you. The next question is from the line of Shashank Gupta from Star Capital. Please go ahead.
- Shashank Gupta:** Can you throw some light on the segment wise revenue breakup that you target for financial year 2017 like in terms of which segment will comprise of how much percentage and some light on the margins?
- Vikas Rathee:** What we had guided towards at the beginning of the year almost 6 odd months ago is that we will like to do north of Rs 2,100 crores of revenue and an EBITDA margins north of 20% and we are committed to that. I can never really create a breakup in terms of how much is going to be which segment frankly, but it will be fairly consistent in relation to the composition we have today on a revenue mix and so between the Creative services and Technology services, both these two businesses will deliver north of 90% of the revenue and on the margin side, you should expect the margin trajectory stage where there will be an increase in the margins, continued increase in margins on the Creative services side of the business and also in the Tech side. So, that is all I can give you as of now we really have not given guidance to the breakup between the different segments, but you can absolutely anticipate 90% of revenues between Tech services and Creative services.
- Shashank Gupta:** And with the kind of order book that we have, do we see achieving target revenue. I means do we have the order book that we need to make the target revenue any such comment that you can share?
- Vikas Rathee:** We will just say that we will stick to our targets to be very frank through the first 6 months, we have got some positive surprises and not much in the way of negative surprises. So, we feel confident that we will exceed our estimate going forward.
- 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 on a quarterly basis, when do you expect to be profitable at the EBIT and PAT levels?
- Vikas Rathee:** Jaineel, thank you very much for the question, we should start seeing that as early as December and March quarter.
- Jaineel Jhaveri:** And that will continue even in next year's June and September quarter?
- Vikas Rathee:** That is the aim and target, not only just to continue but obviously expand that. Frankly, you saw we had pretty good delivery in March and June quarters gone by, September is traditionally weaker as you obviously followed the company for a long period of time. You should see significant progress in December and March and we expect to stay on that trend and if you see the progress in this September quarter vis-à-vis the last year September quarter, we hope to be able to maintain the trend and we are optimistic if that happens, September will start looking green as well going forward.

Jaineel Jhaveri: And in terms of liquidity in the stock and either listing or demerging any of the subsidiary like PFT, is there a thought process or are there any decisions that are taken?

Vikas Rathee: Jaineel, what we can tell you is the management and board of the company looks at any and all opportunities to enhance value for all its stakeholders, so as markets develop and as the businesses grow in size, there are more and more opportunities for each of these businesses to be able to have their own currencies. So, we will continue to evaluate these options on a fairly regular basis with the board and the key stakeholders. So, I cannot really give you any direction from near term perspective but what I can tell you is we are absolutely focused on maximizing shareholder value.

Jaineel Jhaveri: And as for the India FMS business, since it is becoming a smaller and smaller part of the company as a whole, is there any thought process of discontinuing that business?

Vikas Rathee: Let me start addressing that, then Namit can step in, frankly the India businesses is core to what we do, it has become a smaller contribution just because the other business are growing much faster. The India business continue to grow at a good pace, it is very high margin and very cash lucrative. It is the home market for us and it is a key growth opportunity, India media market continues to flourish and grow at fairly high rates. We have got a very strong position in the market as a clear number 1 and what we are able to do is to provide better services, better margins, higher prices, better capacity utilizations, so frankly there is no thought at all of kind of discontinuing that operation that is growing and is growing profitably. From our perspective, we will continue to build on that solid base that we have. Like I said, it just looks smaller because the other businesses are growing faster.

Jaineel Jhaveri: And final question, what would be the expected depreciation for quarter on a going forward basis and what is the maintenance CAPEX for the year?

Vikas Rathee: Like I said, this is obviously in relation to the changes that we have to take on board on the Ind-AS side in relation to this current quarter. So, what you will see is some of that elevated for the first quarter in September, you should see depreciation kind of decline going forward in relation to that. So, that is one. On the maintenance CAPEX side, we are growth company, it is good to say what your maintenance CAPEX is if the company is stable and not really growing much. We have kind of said in the past between the Tech services and our Creative services, we are looking at maintenance CAPEX which includes some replacement over time of basically \$8 maybe \$10 million given where we are but at the same time both companies continue to grow, so there will be some incremental CAPEX. What I can tell you is given the order book that you see across both businesses when we look at any incremental CAPEX, it is absolutely and fully backed by increase in business. We are not in the stage where we have to put in too much of CAPEX upfront hoping business is going to come. So, that is the best I can give you as of now.

Moderator: Thank you. Next, we have a follow-up question from the line of Salil Sharma from Kapur Sharma & Company. Please go ahead.

- Salil Sharma:** My query is about the Dneg, like how much Dneg business we are able to do in India. What I mean to say is that, the idea was to get more and more work to India what we deliver in international market, how much of the work has been able to get done in India?
- Namit Malhotra:** So, to give you a metrics from last year, coming up to March 2016, the metrics that we internally track is the number of potential man days and in the last year we are talking about 4 times more this year which is fundamentally substantial step-up and frankly more than it has ever been in the history of work that has been produced from any company out of India. So we are actually well on our track and in line with our projections to make sure that we are actually exceeding what we had budgeted for the year in terms of productive output from India.
- Salil Sharma:** And I believe that we are also working on Robo 2 that is the Dneg working for them?
- Namit Malhotra:** Yes, we have got operation in India and UK because we have now gotten fully integrated. We are starting to share projects that currently come from India, UK or the US and that collaboration is now consistent across all the big movies.
- Salil Sharma:** So, for that project we are the only VFX producer or we are part of the team?
- Namit Malhotra:** No, we are one of the key players. I do not think we had the capacity at this point to just do Indian movies because we do have substantial flow of work from the Hollywood side. So, we have to ensure that our capacities are appropriately allocated for the pricing that we can get for the same.
- Salil Sharma:** Do you foresee that this trend should continue like are we getting Bollywood industry, doing more work in VFX side and even including the Tamil industry?
- Namit Malhotra:** The growth of the Indian industry overall.
- Salil Sharma:** What I mean to say is that are we getting more of VFX work in India, in the sense do you, so foresee like a positive traction coming from this side of the market?
- Namit Malhotra:** Clearly we have always maintained that India is going to continue to make the big spectacle movies that are today common plays in Hollywood and that India is going to follow and so is China we have seen that. As that part of the industry continues to grow, we are clearly in the best position in India to be able to leverage that and provide the best services out there and that sort of helps create two things. It would help strengthen our team positioned in India and raise the quality profile and as we do that, it also makes us more competitive globally. So, these are very strategic enabler for our business.
- Salil Sharma:** Where I am coming from is that like Bahubali had done a turnover of around Rs 650 crores. So that is one of the biggest hits ever in India's market. So, seeing that how we think are the follow-up happening in the Indian industry and in terms of getting more VFX movies out where Dneg could play a bigger role?

- Namit Malhotra:** I think there is lot of conversation and everybody is interested to see how to make something that is in line with those kind of movies make it for a price, so those conversations are always on and obviously we are at the forefront of that and the sooner we have anything substantial to announce we will reveal to the market.
- Salil Sharma:** But we are not part of Bahubali 2?
- Namit Malhotra:** No.
- Salil Sharma:** Secondly like the earlier speaker was also talking about the depreciation and interest that as a percentage of turnover is pretty high will that trend continue or like the other way around i.e. I think way forward would be sales turnover grow faster than, in that sense the depreciation becomes lower.
- Vikas Rathee:** Salil the way to look at it frankly, is that depreciation should continue to come down. Couple of things -one, we not depreciating only hard assets, we are also depreciating the investments we fundamentally made in relation in Dneg and otherwise given that a lot of that was in the form of IP and other intangible assets. So we obviously are deprecating intangible assets as well., Regardless of our belief that this investment in IP and technology frankly is only adding more value or creating more value for our business but those things do get depreciated at both Dneg & PFW level as well as on the PFT side. So you should continue to see that depreciation actually come down, there is an impact also that is coming in from the Ind-AS that is to how different balance sheet items get treated. So you should expect depreciation as proportion of revenue to continue to come down while revenue will continue to grow, so it will become a smaller proportion. Also some of the IP and the intangibles that we inherited as the part of Double Negative is on fairly fast depreciation schedule. So a big chunk of that intangible already has been amortized, you will see some of them to go away in a fairly quick timeframe and after that, you see a more stable level of depreciation.
- Moderator:** Thank you very much. That was the last question ladies and gentlemen. I would now like to hand the conference back to the management for closing comments.
- Namit Malhotra:** Thank you all for the time today and we want to say that we continue to be on the path of progress and delivering on the promise that we made to ourselves and to our shareholders, we look forward to continuing our conversations next quarter. Thank you.
- Moderator:** Thank you very much. On behalf of Prime Focus Limited that concludes this conference. Thank you for joining us ladies and gentlemen, you may now disconnect your lines.