“Prime Focus Limited Q2 FY18 Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to the Prime Focus Limited Q2 FY18 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 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, ma'am.

Nisha Kakran: Good evening everyone and welcome to the Q2 and H1 FY18 Earnings Call of Prime Focus Limited. We have from Prime Focus, Mr. Namit Malhotra – Executive Chairman & Group CEO Mr. Ramki, Managing Director Prime Focus Limited and Founder & CEO Prime Focus Technologies and Mr. Vikas Rathee – Group CFO.

I will now handover the call to Namit for his opening remarks. Namit, over to you.

Namit Malhotra: Thank you, Nisha. Good evening everyone and a warm welcome. I would like to start the call with my introductory remarks and update you on the Creative Services business following which Vikas will take you through the Prime Focus Technologies' business and group financials.

We are pleased to report the best September quarter performance in Prime Focus Limited's history with robust growth in both revenue and profits which led to the outstanding performance of our creative services division. Globalization of our execution base along with our cost optimization strategy to deliver higher quality work out of our most cost advantageous locations have helped to expand our EBITDA margin to approximately 25%.

We plan to follow the same thread going forward and have accordingly expanded and opened two brand new facilities, one in Chennai in India and the other in Montreal, Canada. Our creative services business reported accelerated growth delivering marquee projects like Dunkirk, Geostorm, Blade Runner 2049, Final Portrait etc. The order book also continues to be robust at approximately $250 million with additions like Fantastic Beasts and Where to Find Them Part 2, Ant-Man and the Wasp, The New Mutants, and Black Panther among others.

Our TV division which is one of UK's leading visual effects provider for television digital platform gained strong traction as well on the back of exclusive content offered by OTT platforms like Netflix, Sky, Amazon Prime etc. We expect this to be a significant contributor to revenues and profitability growth in the future.

Our Indian business continues to be robust. We have delivered marquee projects like Judwaa 2, A Gentleman, Daddy, Baadshaho, Bareilly Ki Barfi, Simran, Bhoomi etc. and our pipeline continues to be strong on movies like Padmavati, Brahmastra, Robo 2 etc.

The GST's impact on the Indian M&E industry is beginning to wane and we expect better Q3 and Q4 numbers in the Indian business as well.

The outlook for all our businesses that is on the creative services side, the technology and the Indian market continues to look strong and as the holiday season kicks in we look forward to promising second half of this year being better than before.

Thank you. Over to you Vikas now for an update on the PFT side.

Vikas Rathee: Good Evening everyone, I would start with an update on PFT as we try to connect with Ramki while he is the US --; he should be available for the Q&A.

PFT continues to deliver margins above 25% threshold. International markets contribution to revenue has started to increase as we have predicted, it is up to about 40% in the quarter. Annuity mix on the revenue side continues to be strong at more than 70% and product to services mix is around 45:55.

During the quarter on the PFT side we signed various new contracts with new and existing clients. On the international market side we have added clients like Take 5 Productions and a distribution house Nordisk, TERN International and AETN this is primarily US and European companies. We have also launched a channel partner relationship with Colortime in Los Angeles.

On the Asia Pacific side, we signed new contracts with BCCI, IMG Reliance, Red Chilies, BARC, Multivision Media, Sony, Lionsgate amongst others. Our brand services business continues to grow very nicely and we have added customers like Big Bazaar, Xiaomi, TVS, Red Label, Maybelline New York just to name a few. We have also produced three short films for the MAMI Festival for Tata Sky and we continue to see this business growing going forward.

We are pleased to announce that Clear Media ERP solution is now DPP certified from the Advanced Media Workflow Association. We are also Netflix certified partner for IMF deliveries and we think this is going to be a good opportunity going forward as both Netflix and Amazon Prime continues to try and invest in the Indian market. We also received the Best of Show Award for the IMF media player at the IBC conference held a couple of months back. That is on the PFT Side.

On the financial perspective, as Namit mentioned it has been the best September quarter for us historically. You all would have noticed that it has been a weak quarter generally for the M&E industry both in India and overseas, based on the results that have come out till date. We on the other hand have been able to produce pretty good results, the consolidated revenues for the quarter were up 18% to close to Rs. 570 crores. The EBITDA adjusted for non-cash ESOP charges increased more than 50% to exceed Rs. 140 crores in this quarter. EBITDA margin also consequently expanded by almost 6% to hit our medium term targets of 25% ahead of original expectations. A big chunk of this has been driven by the growth in our creative services business. As Namit mentioned our operational efficiency continues to improve, our personal cost as a percentage of revenue has now declined from 61% last year to 56%, it is a key metric we track. The non-cash ESOP charge for the period was Rs. 14 crores compared to about Rs. 7 crores for the quarter last year.

Depreciation is about Rs. 70 crores and it still carries some lingering effects of the amortization of intangibles as part of the M&A transactions we did a few years back, it should wane off by the end of this fiscal year. The PAT for the quarter was Rs. 22 crores versus a loss of about Rs. 40 crores last year. Similarly looking from a sixth months perspective, revenue is up 8% to close to around Rs. 1,100 crores, EBITDA for the six months at approximately Rs. 256 crores with a margin of about 23.5%, it is adjusted for the non-cash ESOP charge of about Rs. 26 crores and the PAT for the period is about Rs. 25 crores versus a Rs. 32 crores loss for the sixth months of last year. On a segment wise, creative services revenue is up 26% and EBITDA up almost 88% to north of Rs. 105 crores versus Rs. 56 crores last year. EBITDA margin up around 8% to cross 24%. Similar kind of strong metrics on the sixth month comparison. Revenue up about 12% at around Rs. 850 crores with EBITDA margins north of 22%.

On tech and tech enabled services side of the business especially India has been impacted by the effects that we have faced on our customer side, media & entertainment which was impacted by demonetization and GST. The segment had flattish revenues but our margins are at about 27% so we are happy to be able to deliver enhanced margins even though the revenue has been flat. On a sixth months basis topline of Rs. 170 crores with an EBITDA margin of 27.4%. As Namit mentioned the impact of demonetization and GST is starting to now come off and we see significant opportunities for the second half of the year.

On the domestic India FMS business, revenue was steady at about Rs. 45 crores for the quarter with an EBITDA margin close to 40%. On a sixth month basis the revenue for the business is close to Rs. 90 crores with an EBITDA margin around 40% margin. I would also like to say as of early October we successfully redeemed the scheduled non-convertible debentures of Standard Chartered PE about a month ahead of time. Our net debt to EBITDA figure on the TTM basis is at about 2.4x down from close to 3.7x of last year. So the business continues to improve and our leverage level continues to come down, out cost of debt continues to trend down which is now below 10%.

With this I would like to say thanks for participating for the call and we will be happy to open the line for questions.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session.

We will take the first question from the line of Ali Asgar Shakir from Motilal Oswal Securities. Please go ahead.

Ali Asgar Shakir: My first question is on creative business. So our revenue has grown quite significantly YoY basis. I was just trying to understand if this is on the back of market share gains or the industry growth is healthy across all players?

Namit Malhotra: Looking specifically at our case we have been able to optimize our utilization through this quarter by making sure that we have timed certain marquee projects that have come through on our end. Needless to say that it comes with higher percentage of profit being generated by leveraging our lower cost capabilities that are also continuing to grow every quarter.

Ali Asgar Shakir: The margin is again pretty healthy in the quarter. So just trying to understand from an outlook point of view that $250 million order book that we have, does it also have a similar margin profile or should we actually expect the margins to improve from here in the next two quarters. Of course you did mentioned that overall medium term margin target is about 25%. But even from a Q3, Q4 standpoint is it that better utilization and order book margin profile can improve from here?

Namit Malhotra: We would like to maintain the target that we set ourselves for, we have obviously delivered faster than that but we would not raise the target yet again. I would hope that we continue to at least deliver the numbers that we have given as target and do it on yearly basis.

Ali Asgar Shakir: So this 24% margin for Q2 FY18 this should remain here for the next two quarters, is that what you mean?

Vikas Rathee: The second half of the year on the creative services business side is always stronger for us. I think what Namit is saying is we are not looking to raise our guidance as of now from a consolidated 25% EBITDA margins perspective. Obviously we are very happy with the results for the second quarter which is typically our weakest. That is why as you see the growth momentum and strong stability in the business continuing we hope to be able to exceed our targets.

Ali Asgar Shakir: On this TV business in UK, Namit mentioned that the OTT platforms like Netflix, Amazon is driving our UK business. Are we also trying to get business across other regions in US and how is the OTT platform business across other regions, is that also growing?

Namit Malhotra: It is fair to say that there is no such thing as an OTT business that operates in UK versus US, all these are global accounts. They are not making contents specifically for the UK or the US. Because our production base is out of the UK, we are executing this work out of the UK much like we do for Hollywood. So it is ultimately coming out from the same pot at least on the western part of the world perspective.

Ali Asgar Shakir: And can you just throw some light in terms of the growth opportunity over there and what sort of margin profile it can give us and the contribution it can have to our overall creative business?

Vikas Rathee: TV is just one of the ways we call it, this is fundamentally work coming through the global digital / OTT players. This part of the business is rapidly expanding as an industry, the target customers here for example are Netflix, Amazon, now Google and Apple is getting into it. There is also HBO, Sky and other such players which are looking to create more original content to grow their direct to consumer models. So this part of the business as an industry is growing rapidly.

Netflix announced they have content production budget of $8 billion for next year. So these are tailwinds and TAM expansion from an overall industry perspective. We are one of the key players globally and we hope to get frankly more than our fair share going forward. So this is a big growth area here for us.

Ali Asgar Shakir: Just one bookkeeping question on your ESOPs. Could you just throw a number that we will probably have towards the ESOP charge in the next few quarters?

Vikas Rathee: We have spoken about it in the past that these ESOPs were granted almost a year back. It is going to be one to two quarters of FY19 by when this goes away, but it is on a declining side. You will see by March'18 this charge will come down to less than half of current figure.

Ali Asgar Shakir: Okay and what about the next two quarters?

Vikas Rathee: It is going to be in a similar range, slightly lower. You will see it come down slightly for December'17, slightly more for March'18 and then from June'18 it will be close to half of what you see right now.

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

Jaineel Jhaveri: My question is mainly for Ramki. If you can just give us an update on PFT, what you see out there and your thoughts on the quarter since there was no growth what happened and what are we doing for the future?

Ramki Sankaranarayanan: As Vikas mentioned the international mix of revenues continue to grow, this is a consistent theme that we have talked about over the past several quarters. It is now 60:40 and so that augurs in line with what directionally we have been attempting to do. We have been spending a lot of time augmenting our sales force, recalibrating our sales force to be able to go and penetrate some of these markets little more aggressively than we have been able to conventionally, that is one construct that is playing out well.

Similar theme as pointed out by Namit about OTT players like Netflix, Amazon and others, which have been producing original content and that phenomenon is playing out for Prime Focus Technologies as well. That it is across the board, increasing demand for us whether it is media processing, media localization or just a media ERP technology side on the back of the scale and automation requirements.

What is different in this particular trend of increasing the number of hours of original programming by Netflix is that they instantly have to ensure for the content to be available in over 100 markets simultaneously. This means there is concurrent demand that needs to play out for content to be instantly available for that many number of countries and this is actually a new trend because previously it was far more linear, staggered. When you want to do this on an aggregated concurrent manner there is increasing need for technology and scale and those two interesting things are showing up on the demand side for us in the future.

This particular demand is increasingly becoming interesting because they want far more agility and automation of the supply chain and most importantly they want to reduce the total cost of operations. That is where the media ERP technology and our investments clearly play out and some of our international wins have all been in this construct, where we eliminate costs through automation and that is why there is robustness for us in international side.

On the India side, we have had a flat growth. Going forward overall growth for the business is directionally in the right place.

Jaineel Jhaveri: In terms of the Star contract are we seeing any repercussions because of the HBO episode leak? Is there anything on that front are we seeing a drawdown of business from Star or there is no effect?

Ramki Sankaranarayanan: At this time we do not see any effect, it is business as usual. In fact we have added to some of the volume that we traditionally do. So we have not seen an effect of that so far.

Jaineel Jhaveri: And you all do not foresee also any effect?

Ramki Sankaranarayanan: With the information that we have at this point in time we do not see that playing out negatively for us.

Jaineel Jhaveri: And when do you see growth coming back to PFT of whatever deals that you all are signing on right now. Would we see this actually translate into numbers six months from now, one year from now?

Ramki Sankaranarayanan: Over the next few quarters we should see growth coming back up. There is a very strong pipeline at this point in time and over the next few quarters we should see that shaping up well for us.

Jaineel Jhaveri: My next question is for Vikas or Namit. What is the progress in the front of the PFW listing like are we still planning on doing it and if so where are we in the process?

Vikas Rathee: As we have said in the past is we believe our share price in India does not fundamentally reflect the value that we have on the PFW or PFT side. As a management team, as a board we continue to evaluate any and all value unlocking options. Obviously we want to try and communicate our value to you all as clearly as possible. But that is an active process and we keep looking of methods to unlock value. Is that a listing or some other way but there is nothing more to add as of now. But rest assured the company's financials as you see have demonstrated the serious growth we have in our business quarter-on-quarter. It should reflect back in our share price and we will evaluate any and all options to make sure we can deliver that value.

Jaineel Jhaveri: What is the amount of money that we have spent for CAPEX for this first half and what are we going to spend in the next half and FY19, if you could give me those numbers?

Vikas Rathee: We have spent around Rs. 80 odd crores through these six months across the businesses and includes hard CAPEX as well as IP creations that we have in the business and gets capitalized in small portion. If you remember we had guided that we should look at this fiscal year CAPEX in range of Rs. 160 - Rs. 175 crores depending on the FX. So if you see it from that perspective we are at 50%.

Jaineel Jhaveri: And next year would be approximately the same amount Rs. 170 crores, Rs. 175 crores or will it taper off?

Vikas Rathee: CAPEX on maintenance perspective across the group is not more than $10 - $12 million, i.e. about Rs. 80 crores- 90 crores. Everything else is coming on the back of contracts and growth that we see that is where the opportunity is. If we see more dependable growth beyond our base budgets and targets then we might have to spend more.

We look at CAPEX very seriously, for every single rupee and dollar we spend. We would not want to compromise the growth opportunity for the lack of just restricting CAPEX. But on a base case basis if we stay where we are there is no reason why CAPEX should go up. If we see more opportunities and companies like Netflix, Amazon want us to do a lot of work next year, we might be in a situation where we have to spend more. But it will be very well worth if we do.

Jaineel Jhaveri: And when you say this Rs. 160 crores to Rs. 175 crores CAPEX this includes the $12 million, right?

Vikas Rathee: Yes.

Moderator: Thank you. We will take the next question from the line of Salil Sharma from Kapur Sharma and Company. Please go ahead.

Salil Sharma: My question is regarding the domestic turnover. You have stagnated more or less close to Rs. 45 crores. Do we see any uptick in that post the Bahubali which you have mentioned in the presentation and even say the Padmavati conversion? And do we see any kind of uptick there?

Namit Malhotra: See the uptick is certainly there, some of these high end projects like Padmavati etc. even though they come from the domestic side they are actually factored into the 3D side of our business which is on the Prime Focus World side. So the uptick is there but that is being factored in as part of our international offering. So what you see on the India side may be a bit flattish because you are not seeing that growth because technically Indian business does not do 3D and that is why we would not be able to capture the upside of that in that P&L.

Salil Sharma: Any news about Brahmastra, the business will come in the next one, one-and-a-half year?

Namit Malhotra: That is right.

Salil Sharma: The Company is not involved in any production or taking the production cost?

Namit Malhotra: No.

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

Apurva Mehta: Sir, just wanted to ask, how is the order pipeline and the deal sizes which you are looking for now?

Namit Malhotra: The order pipeline as we said continues to be consistent and stable. We are obviously making sure that our outreach is much more diversified from the last couple of years. So we are doing feature animation, big ticket Film VFX, OTT what we call TV and digital output, TV animation.

So we are obviously looking at spreading the entire business across each of these verticals where we are trying to ensure that our available capacity and infrastructure is best utilized. We continue to see decent amount of demand across all the various sectors. Also because we are technically hitting at two or three more verticals than we traditionally did and that obviously gives us a wider market to really go after.

Apurva Mehta: And sir, typically what will be the deal size a year back and today what you must be targeting?

Namit Malhotra: We do not really look at the business in that manner.

Apurva Mehta: Sir, you are expanding one facility in Chennai and Montreal in Canada. So what is that expansion for and is it that we have exhausted our capacity in Mumbai and everywhere and we are expanding for that?

Namit Malhotra: Yes, so Mumbai capacity for now has been completely tapped out. Also it is very clear that having additional capacity in Chennai means that our operating cost in India will also go down and we will have access to a wider talent pool which exists in that part of the market. Additionally the Montreal side act as an active revenue center on the other side of the world which is lot more attractive given the incentives provided to the studios. So we are trying to make sure that while we expand our revenue potential we are also expanding our executional capability and doing at a lower price.

Apurva Mehta: So sir, outsourcing from India as percentage would be compared to where we were one year or two years back, any figure that you can share

Namit Malhotra: First of all we do not ever look at the business from an outsourcing standpoint, we are an integrated player because we cannot really outsource work in the way traditional outsourcing company would work. What we are able to do now is at every quarter once we deliver a certain kind of project internally we get more and more comfortable and confident that our teams are able to deliver more complex work from the Indian center. This bodes well in margin expansion and allows us to then go after more work on the other side because you are able to do more complex work at a more competitive price which enables us to be more competitive also on the business development side. So that momentum we are trying to create but it is more driven by our ability to be not just more competitive but also keep the scale going higher.

Also to appreciate that the business we are in every time we work on some of these big movies and big projects that we talk about the natural demand from our client is also to do more and more complex work. Because otherwise for the average consumer there is no real attraction to go back and watch the part 2 or the part 8 of the same movie or the same idea if they are not going to get an even more exciting experience. This is how we think about the business and we have to keep developing technology to deal with that and at the same time figure out how we can do more and more of complex work at a lower cost.

Apurva Mehta: Would you now be facing any competition from Disney and all the old guys who are there, is there any big competition or now we are one of the top leading creative supplier in the industry today?

Namit Malhotra: We are clearly in the top 3 companies out there. Of course there is no question Disney is frankly more of a customer than a competitor, we never look at studios as competition. We look at them as our partners and our customers.

Apurva Mehta: When we are bidding for something, do they look at the cost front or more at the creative front which we are having, what they would typically look at?

Namit Malhotra: Because of the level playing field we are in, at our scope and scale it is a factor of really looking at our ability to deliver cutting edge work. That is the first criteria and once you look at the fact that there is a cutting edge output, the next question is how competitively priced we can be in that space. But going in with a lower price does not help us win the project, it is our ability to convince our clients that we can do even more cutting edge work in line with their expectation is the metric that is always looked upon as the primary driver of our delivery.

Apurva Mehta: Sir, on the animation side where we see ourselves two years down the line. Is there any big projects which we are going to launch or anything like we are working on.

Namit Malhotra: We are already in production on one project and we actually announced that we will be launching hopefully series of projects with an entity called Locksmith Animation. They have formally been given their first win at 20th Century Fox and are going to be in production on the second one also soon. That shows the fact we are already playing in what we call high-end feature animation side.

Apurva Mehta: And typically what will be the size of that deal in that animations like? It will be typically long project also, long gestation project?

Namit Malhotra: It can be from as little as US$25 million to US$100 million depending on what is the specific scope of work and vision laid out by the studio so it is a wide range at which some of these things can be done.

Moderator: Thank you. The next question is from the line of Salil Sharma from Kapur Sharma and Company. Please go ahead.

Salil Sharma: My question is regarding the bench in terms of the employees like the utilizations of employees is it 80%, 90%?

Vikas Rathee: As we spoke in the past our utilization levels in the western world is above 90%, our targets are in the 95% odd range and we are able to manage it in that ballpark. On the India side our targets are north of 80% and again we are able to manage it. There is a little bit of up and down that happens. This also again takes in to account that there are people who are being trained to go from one level of complexity to the next level complexity as Namit mentioned.

So when we say that we open a new center in Chennai is about making sure that we are attracting new talent which is more regional in nature and there is less churn because we are the only real player in that market that are providing that work opportunity. Mumbai there is always a little bit more competition. So we are at 80%, there might be certain times when we dip slightly below and there are times when we get close to 95% plus even in India depending upon delivery of projects.

Salil Sharma: Okay and in terms of Dneg how much work are they doing abroad like is there a metrics where we say 75% of the work got executed there and 25% in India or something like that?

Vikas Rathee: Dneg and PFW is the same thing now that is just a slightly more of a customer facing brand. Just to give you an example we have around 6,500 people on the creative services side and almost 4,500 of them are in India. So from a human resource perspective it is back in India. India acts as a cost plus center for us. So difficult to say the exactly revenue, we are trying to deliver margin on a consolidated basis. I can tell you that every single project that we do under the creative services business side has a growing proportion of work coming out of India. So it is not a question of just to do only this work or that in India. If you ask me year-and-a-half ago it might have been 5%, 10% today we are north of 20% of every project work is getting done in India and the aim is to try and keep on increasing it.

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

Namit Malhotra: Thank you all for participating in today's conference and I hope you all are pleased with the numbers as we are and we continue to keep striving and delivering the best for the company and for all our stakeholders. Thank you.

Moderator: Thank you. Ladies and gentlemen, on behalf of Prime Focus Limited, that concludes today's conference. Thank you for joining us and you may now disconnect your lines. Thank you.