"Balaji Telefilms Q2 FY20 Earnings Conference Call"

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Moderator: Good day Ladies and gentlemen and welcome to Balaji Telefilms Q2 FY2020 earnings conference call, hosted by ICICI Securities. As a reminder, all participant lines will be in the listen-only mode. 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 Mr. Sanjesh Jain from ICICI Securities. Thank you and over to you Sir!

Sanjesh Jain: Good evening everyone. We would like to thank the management of Balaji Telefilms to give us an opportunity to host this call. From Balaji Telefilms, we have Mr. Sanjay Dwivedi Group CFO and Mr. Nachiket Pantvaidya , Group COO and CEO of ALT Digital Media Entertainment. I would now like to hand the call to the management for their opening remarks and post that we can open the floor for Q&A. Thank you and over to you Sir!

Management : Very good afternoon. Thank you for joining us on our Q2 FY2020 earnings call. I hope you all have had a chance to review our earnings release published yesterday evening. The first half of the year has been very good for us and we expect to carry that momentum into the second half of the year as well. Starting with an update on the TV production business, we continue to drive the rating for the broadcasters we work with. We have 17% market share in prime-time rating, which is still more than our production houses rank 2 and 3 combined. We had eight shows on air during Q2, two shows on Colors, where we accounted for nearly 12% of the prime-time rating, 2 shows on Star Plus accounting for 18% of prime-time rating and 4 shows across ZEE and its sister channel &TV accounting for nearly 40% of their prime-time rating. Overall, we produced 210.5 hours of content at an average realization of Rs.36 lakhs an hour. We continue to see gross margins at over 30% given a relatively unchanged line up of our shows plus Our focus on minimizing cost for the initial episodes for new show launches. Going ahead, the TV business will see the launch of the 4th season of the iconic show Naagin and new show on Star Plus to replace Yeh Hai Mohabbatein, which is now in its 6th year of telecast. Overall the TV business remains on a solid foundation and will contribute significantly to the earnings for the year.

Coming to our movie business, we had an exceptionally good performance primarily driven by the superhit movie Dream Girl. We started the year with four movies, three of which have already been released, Judgementall Hai Kya, Jabariya Jodi and Dream Girl were released in Q2. Dolly Kitty Aur Woh Chamakte Sitare, the 4th movie for the year, had its premiere at the Busan film festival and is expected to have its commercial release later this financial year. All rights associated with these four movies are presold ensuring strong profitability for the year.

Balaji Motion pictures continues to focus on presales and co-production of its future slate and our capital commitment to the movie business remains limited. We are working on a few exciting concepts for FY2021, which include new movies from some of our old successful franchises such as Shootout and Villian. ALTBalaji continues to establish itself as a preferred choice for urban mass Hindi content. Our collaboration with ZEE5 has gone live since September and while it is still early days, we have seen a lot of positives from it. We co-produced five shows till date with ZEE5 taking the total library of shows to 48. As part of this collaboration, all the co-created original content will only be available on ALTBalaji and ZEE5 behind the pay wall and not be free to consumer via distribution partner. Also, note that the 43 shows produced prior to September 2019 are available exclusively on ALTBalaji and this library is a big draw for the new OTT audiences, which were using to drive our direct subscriptions. Our current active subscriber base stands close to one million and we continue to see good traction on the direct subscription front.

We are ranked #4 grossing app across IOSs and Androids despite one of the lowest subscription prices in the country. Our deal with ZEE5 will help us get committed revenues towards content creation while allowing us to grow our direct subscriber. The partnership allows us to conserve our cash burn by way of co-production and move towards becoming profitable and a valuable OTT. The full financial impact of this collaboration will be seen in the coming quarters.

To summarize, we have a very good foundation across all the three business verticals. TV remains cash generator and will continue to do so. Our presales of movies with an upside sharing will result in strong profitability in the movies business. ALTBalaji is moving towards breakeven while minimizing cash burn. We have had a good start and hope to continue this across Q3 and Q4. I will now hand this over to Sanjay Dwivedi, our Group CFO to give you a quick update on the financials.

Management : Thank you. I hope you all have seen the results presentation available on the website. Financially, we had a very good quarter. The key figures on a standalone basis are as follows:

Our TV and movie business had a very strong performance driven by increase in production hours and three movies released in this quarter. Please note that the Q2 financials does not include additional revenues and profitability from the sale of satellite rights, which is to be accounted in Q3. Gross margins on TV continue to improve and we have seen the fifth consecutive quarter of margin improvement led by strong focus on cost control in production. We had one new show launched during the quarter and have managed to optimize the launch episode cost effectively.

Q2 PAT at Rs. 15.5 Crores against Q1 PAT of Rs. 2.5 Crores and Rs.7.1 Crores in Q2FY2019. H1 FY2020 PAT at Rs. 18 Crores. We currently continue to account for tax at normalized rate and expect to move to the newer lower tax rate on utilization of the available MAT credits, which is approximately Rs.12 Crores currently. ALTBalaji continues to witness strong revenue growth, Q2FY2020 revenue at Rs. 20.01 Crores. H1FY2020 revenue at Rs.32.4 Crores against full year FY2019 was Rs.42 Crores. Full financial impact of collaboration with ZEE5 to be seen in Q3 and Q4 financials as this collaboration went live towards the end of the quarter. I would like to highlight that on a consolidated basis, we have achieved positive PBT after nearly four years given we have been investing heavily in ALTBalaji. We hope to continue this momentum into the coming quarters. Mutual fund investment as of 30th September 2019 was at Rs.233 Crores. Additionally, movie inventory and receivables stood at Rs. 80 Crores to be realized in the coming quarters further bolstering our cash reserve. I thank you all for joining us today and now would request the moderator to open the Q&A session. Thank you.

Moderator: Thank you very much Sir. Ladies and gentlemen, we will now begin the question and answer session. We have the first question from the line of Rajesh Agarwal from Moneyore Capital Advisors LLP. Please go ahead.

Rajesh Agarwal: Question is on ALTBalaji. The arrangement, which we have with ZEE5, is only for the cost of content production?

Management : No, they are also going to get to use it on their app and this is an exclusive arrangement where they have to put it behind the pay wall.

Rajesh Agarwal: Suppose I am a Vodafone subscriber, I am getting ZEE5 free. So, it is not behind pay wall then.

Management : Correct but Vodafone will have to pay to ZEE5. So, there must be some payment . And this content is part of the premium zee5 package

Rajesh Agarwal: But ALTBalaji will get the sharing from that?

Management : I cannot disclose the details of what the contract is exactly.

Rajesh Agarwal: It is only cost of production or is it for revenue also? That is what I want to know.

Management : It does not matter whichever way it is. All we are saying is that we will show this income as a part of our top line going ahead increasing revenues.

Rajesh Agarwal: Then how do we breakeven? Suppose we are not behind pay wall, the subscription number will reduce, will it be one million?

Rajesh Agarwal: I wanted to understand, suppose now we have got 2.4 million total subscribers. The ARPU is at Rs.25?

Management : On three platforms of Telcos. the content has been taken out and only the shows that are made post September 1st are available on ZEE5. 42 shows made before 1st September are not available anywhere with ZEE5.

Rajesh Agarwal: But will the revenue come down for ALTBalaji or not, that is the question?

Management : These 42 shows have not been given on any partnership platform. So, we will be the only person to monetize these 42 shows. So that will make good and allow us to achieve break even. The remaining cost base that we are not getting subsidized from ZEE.

Rajesh Agarwal: The 42 shows, which we have got exclusively, that will sooner or later will become old shows?

Management : Old in the sense?

Rajesh Agarwal: Old means in terms of time lag. After six months nobody would like to watch the old shows

Management : What is the basis of that assumption, because somebody whom we acquire today has not even seen in any part of our shows, for him or for her everything…

Rajesh Agarwal: My question is why should he come to ALTBalaji platform, he can go to ZEE5 for the new show.

Management : No, for the old show they have not seen and in your mind, these are old shows. By our argument there can be no library business in digital OTT and all the other big names should just launch what is there in last month. So, the person who comes in for the first time would like to see that show that is the basis of our business, fundamental of the digital business.

Rajesh Agarwal: So, you feel there would not be any loss of revenue for ALTBalaji going forward?

Management : Revenue, no. I think our revenue numbers are Rs.7 Crores for the first year and Rs.42 Crores for the second year and the guidance that we gave on CNBC is around Rs.80 Crores for year three. So that loss is not there, we are nearly doubling.

Rajesh Agarwal: After that, the cost of production after sharing may be around Rs.60 to Rs.70 Crores, total expenses?

Management : We roughly have an annual cost base including content, technology, marketing anywhere between Rs.160 Crores and Rs.180 Crores.

Rajesh Agarwal: But the content production will now get shared with ZEE5, will that go away?

Management : No, it will not go away because we have to take some percentage of the cost on our books, so that we will recover through the direct subscription that we do on the exclusive library.

Rajesh Agarwal: Then revenue for the breakeven, we should do Rs.160 Crores to Rs.180 Crores.

Management : You are right.

Rajesh Agarwal: Sir, the second question is on the TV side. How much was the movie contribution in the standalone?

Management : On the quarter, movie contributed close to Rs.12 Crores.

Rajesh Agarwal: Okay, it is Rs.12 Crores revenue or EBITDA?

Management : PBT.

Moderator: Thank you. We have the next question from the line of Anirudh Agarwal from AAA Investment. Please go ahead.

Anirudh Agarwal: Thanks for the opportunity. Sir, my question was strategic and long term, how do you see this whole OTT space evolving, I mean very competitive space, too many players now, but in a couple of years how do you really see these moving

Management : Well, there are two aspects to the OTT space; one is that from a consumer portion it will be segmented along two lines, either you are targeting the classes which is, let us call it equivalent to people who are buying Apple phones today, probably the top 20% of the market and there will be another content strategy and price strategy for the masses, which is the rest of the 80%. The market will be sharply differentiated into these two. We, of course, will be part of the 80% mass strategy. Secondly, I think it is important for us to keep tracking the movement on the Telco and the prices of Internet. The way we are reading headlines today in papers, it seems like Telcos are finding it difficult to generate the promised revenues and therefore we have to keep a close eye on whether Internet will become costlier in India or not. So that is the second factor over the next two years, which should be taken into account.

The third factor is that 70% - 80% of the revenues are based on advertising today. If you take a total digital OTT space. These 70% - 80% of the revenues are coming through catch up television advertising from broadcasters. Now, that I feel is leading to a dilution of the broadcasters' television ratings and I think at some stage the broadcasters will have to take a balanced view of how much are they going to give free on catch up and how much they give on TV. So that is one part that will decide this 70% - 80% of the revenue chunk. If you look at most analysts' report they are saying in the three years' time, the split between pay and advertising television, which today is about 15% - 85% in favour of advertising will move to 40% - 60% in favour of pay television. The last and most important point is that, I feel we will not have any increase in pricing for end consumer pricing over the next two or three years. We are going to see a market where less than a rupee per day of pricing is the norm. We can see that two competitors have reduced their prices in one year from launch and one has gone to one third and as a mobile only price and another has also gone to Rs. 365. So I think this will stabilize at Re.1 per day pricing. Eventually, when there is enough original content in the market, sachet pricing will emerge as an entry level strategy to acquire consumers because it is extremely difficult for everybody to spend consumer acquisition budgets to acquire consumers. So, content will have to bear the load of acquiring consumers as opposed to just marketing budgets.

Anirudh Agarwal: Thanks for the detailed reply Sir and, what is your strategy to counter because the competitors that are there have very deep pockets right, whether it is Netflix, or Amazon or Disney with Hotstar now. So how do you really think about that and would it make more sense for us to simply be a content creator and display that across OTT platforms versus having our own OTT?

Management : There are two aspects to the question, first is as for the strategies to counter deep pockets, I think what we have to do is, we will breakeven and therefore we do not need the deep pockets. We are right now inching towards breakeven like we have always promised, between 36 – 48 months of launching ALTBalaji we will see quarter where we will have breakeven, cash breakeven has already been achieved. We are a debt-free 250 Crores plus cash company. So, we are positioned much better than many companies who are loaded with debt. Plus our TV business contributes over Rs. 50 Crores cash each year.

Management : So, we are okay in terms of where we want to be on the balance sheet and P&L. In terms of, targeting, we feel that we have our content strategy laid out for us and we have an early lead. We have put out 48 original shows, which nobody else has, even the nearest competitor has put out only 24 shows in Hindi or less than 24. So, we have a significant lead and I think that will drive us going forward.

Lastly, we are focused on our breakeven targets, which we will achieve and therefore we are right sizing our business to this. We are not a bottomless hole where you have to keep showing widening losses and keep acquiring consumers. We do not believe in this philosophy at this stage. We first want to have the proof of the pudding, we want to break even and then use our rich analytics data to launch phase 2 of our strategy possibly two years from now.

Anirudh Agarwal: Right, and what would be the phase 2 of the strategy, what are your thoughts right now on that?

Management : Well, there are two aspects; one is, I think we need to produce enough content to sachetize content much like in the shampoo and soap markets, if we can sell our content at Rs.2 a day that will help us take our ARPU to Rs.730 a year. So, currently we are Rs.300 a year. So, first we have to produce enough content and of course, enough hit content to be able to sachetize our pricing, two years from now. Secondly, we have to be able to cater to two major target groups. One is the under-served male viewing audience, which is under served on TV in terms of shows and secondly, in terms of individual female 20 to 40 viewerships is something that we have to target. These are the two major target groups in terms of our audience and we have to develop a significant library there. Thirdly, we will have the richest data in terms of numbers and analytics and we need to build an efficient recommendation engine two years from now to be able to optimize retention. Right now, because of the massive inflow of the new Internet users, retention is not top priority also. We do not have more than 42 shows. Once we reach 100 shows, taking a recommendation engine, investing in more AI&ML to ensure that retention happens will bring down the cost of consumer acquisition and retention considerably. So, these three moves will take us into the next step. We will also evaluate one single regional language to go into. Our learning so far has been that sporadically launching single shows in languages cannot attract audience like you cannot just do one Bengali show you need to do 25. So, we will probably explore a business plan of launching it in one south language.

Anirudh Agarwal: Right, Sir thanks for that and what would be your churn rate right now in terms of your subscribers?

Management : 66%.

Anirudh Agarwal: 66%, so over a period that would have to come down, right, otherwise the customer acquisition cost would never be justified by the lifetime value of the customer.

Management : No, we are well above our stated margin because while we quickly use the term churn rate, the person at the other end who listens to the term has no idea whether it is three months churn rate or there is a one-year subscription that is churning out. So, there is more mathematics involved. It is just a number that I gave you 66% but I think at 20% - 25% churn rate we can sustain well. We are finding that people who step out of quarterly subscriptions come back, may be a quarter later when the next season of the show that they like launches. So, as we do multiple seasons, we will have our churn rate reducing to some extent. What is more important than churn rate is to develop a recommendation engine that allows us to keep cohorts of audiences in place which we will do in some time. Right now, we have 40 shows, so if we plot 10 cohorts that is only four shows per cohort, that is hardly any recommendation. So, we need to kind of come to that to really improve.

Anirudh Agarwal: One more question on the content cost, so how do you see, because of so much competition and all the major media players also now investing behind their own OTTs, how has been the inflation in the content cost and what would the comparable cost of producing say digital content versus TV content?

Management : We have often answered this question for the last 13 quarters. It is three times, 2.5 – 3 times the TV content one, and secondly, in terms of competition gearing up we are by far the market leader in terms of number of original episodes put on. Everybody else has got single digit number of original shows that have been put on. If you do a real scan, it is a common question to be asked that the competition is heating up but I think it is heating up in the press, not on the app. We are confident that the number of shows we put up are far ahead of anybody in competition in the Hindi space. Of course, it is different in the Bengali and the Tamil space but we are focusing on the Hindi space. So, we do not think that the competition is heating up. It is heating up in the movies acquisition market, which is overstated. We are not in the market. We are selling the movies instead of buying them, and therefore we believe that we have an early lead both in terms of data and acquiring customers in the original series segment in Hindi.

Anirudh Agarwal: Thanks for that and one final question. Over a period, how do you see people shifting from TV as a medium to OTT or both will go in tandem, do you think that TV market in India in terms of subscribers is still going to grow?

Management : If you look at the ratings of the top channel urban ratings, four years ago they used to have 300 GRPs today Sab TV which is the current week leader it is at 181 GRP. So, you can see the drop itself, what has happened is the broadcasters are offering their own shows free on Internet on their own OTT platforms. Internet itself is free, 1GB is free. So, people can watch it for free and in a way, I think that is cannibalizing audiences for television. Why would anyone pay a Rs.150 to Rs 450 cable tv charge when you can watch all the content free on your own mobile service today on TV.

Anirudh Agarwal: But what implication does that have for our business? because there is a lot of money still made from the TV business. So, if that business goes away in the future,?

Management : We never said it will go away. I am just saying that the viewing is shifting to digital. You get advertising on digital. Like I said, 80% is digital advertisement.

Management : We still need that shows to be produced, whether it is for digital or for TV.

Management : Yes, it does not matter.

Moderator: Thank you. The next question is from the line of Yogesh Kirve from B&K Securities. Please go ahead.

Yogesh Kirve: Hi, thanks for the opportunity. Just understanding the deal with ZEE, is it that we will book the entire cost and we get certain assured revenues from ZEE for sharing the content or there is a sharing of cost?

Management : We cannot give you the details at this stage suffice to say that it is linked to the number of shows that we make for them. If we make more shows for them, you will get a better price from them. Now, there is IP sharing involved, so it is not exactly what you are saying. It is not a production-commission model. Importantly, the ZEE deal understanding is that we shift from a multi-partner system to a kind of pay base single partner system. We are also kind of exiting the Telco environment to partner with the broadcast environment. As part of our strategy, in our first two years, we had to use the widespread Telco environment because , we had a smaller library, which was growing every month but it still was small. Secondly, the cost of consumer acquisition and marketing was high. Now, we feel we are in phase 2 of our business where we will go with single-partner model, possibly in two or three years we will also be able to have enough library and like I said add enough data to be able to acquire consumers efficiently.

Yogesh Kirve: So, to understand the financials, I think the deal was already live in the Q2, right, towards the end of the quarter?

Management : We had totally 25 days of the deal in the 90 days and one of the major shows happened in the last day of the quarter. So there is very minimal impact.

Yogesh Kirve: So, this deal will have more implication on the cost of production going ahead or it would have implications for the revenues as well?

Management : It is a revenue item, so it will have implication for that and in terms of cash flow, of course, it is a big boost. So, I mean the broad story is that because of the deal and because of efficient management of other businesses, we can present a debt-free 250 Crores plus cash company and we are well equipped to take on the future. We believe that we will invest conservatively and not go over aggressive and be rational about the way we invest in our businesses but the happy news is that after at least about 10 – 12 quarters we are seeing a PBT level breakeven in the last quarter, which will be improved in the Q3 and Q4 because the ZEE deal.

Yogesh Kirve: In terms of the number of shows, there are about 42 shows in two to two-and-a-half-years, up to 17 shows per year. So, this should be sort of the rate of additions going ahead as well, 16 – 17 shows annually?

Management : No, it will be more this year because with the ZEE deal and our better understanding of the market, we will produce more shows. The uncertainty that was there in the early days when Jio gave Internet free, is now slowly settling down. So, in the first year, we started off with a certain target audience but just before launch Jio launched and jiofication of the industry meant that it became a mass phenomenon. So, I think, at that point in time we had to take stock of the kind of shows that we were making. We also made a few regional shows, which distracted us from our Hindi central idea. Now, all that is gone and therefore we are looking at a 24 – 30 show rate every year going ahead. Also, the number of episodes per series are getting longer than 10 that is where we are going.

Yogesh Kirve: Sir, in terms of the television business looking from the next one to two-year perspective, do we anticipate an increase in the volumes in terms of number of shows or number of programming hours from the current levels?

Management : See, the television business is predicated right now on four super brands that we do, that is two shows on ZEE Kumkum Bhagya, Kundali Bhagya, Naagin and Kasauti on Star. These four contribute a huge sum and they will continue going on for some time. I feel we will hit a capacity constraint beyond 10 shows for about 1000 – 1100 hours and that is where we are at 8 shows right now, at about 10 – 11 shows I think the inefficiencies might set in up and capacity constraint.

Yogesh Kirve: Right, but we have visibility on at least 8 going to like 10, 11, are we working towards that from next two-year perspective?

Management : We have not signed contracts yet. For contracts to be signed, you will need to have a change or a major change in the way the companies or the broadcasters are programming. I think those changes happen either pre- IPL in February or then straight in July post IPL. These are the two seasons. So, we will be able to better address that issue somewhere in February or then again in post the IPL, which is in July – August if you want a concrete answer but otherwise, in terms of visibility, sure we want to make 10 shows, but we want to make sure they all are profitable.

Yogesh Kirve: We had certain advances given to various artists, so where do we stand on that as of today. Are there any pending advances?

Management : Advances which are paid, resides in balance sheet and the moment the movie goes on floor or the show goes on floor, the advances become inventory for us.

Yogesh Kirve: Do we have any advances which are as of September?

Management : We cannot be in the movies business without paying advances.

Yogesh Kirve: My question was specifically to the film business.

Management : The topic was film only. You need to sign a talent today to get the movie done in a year's time. So, you need to pay advances that are how the system works.

Yogesh Kirve: Yes, my question was, is it possible to quantify that figure as of September?

Management : Currently capital employed in movie business is around Rs.100 Crores. We will like to continue just around that.

Moderator: As there are no further questions from the participants, with this we conclude the conference call. On behalf of ICICI securities that concludes. Thank you for joining us and you may now disconnect your lines.

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