Eros International Plc
Third Quarter Fiscal 2016 Earnings Call

Please note: this transcript is an unedited record of what was said at the Eros International Third Quarter Fiscal Year 2016 analyst and investor call on Wednesday 17th February, 2016. It may be imprecise or capable of different interpretations, or may contain errors. As such, any information or opinion expressed in the transcript should be cross-referenced to other published, verified material before relying on it.

Operator

Good morning, ladies and gentlemen, and welcome to the Eros International Third Quarter Fiscal Year 2016 Earnings Conference Call. This call is being broadcast live on the Internet and a replay of the call will be available on the Company's website.

This morning, the Company published its earnings press release on its website, erosplc.com. The Company would like to remind everyone listening that during this call, it will be making forward-looking statements under the Safe Harbor provisions of the Federal Securities Laws. The Company's actual results may differ materially from those projected and the forward-looking statements. Additional information concerning factors that could cause actual results to materially differ from those in these forward-looking statements is contained in today's press release.

During the call, the Company will also discuss non-GAAP financial measures, in talking about its performance. You can find the reconciliation of these measures to the GAAP financial measures in the Company's press release.

I would now like to turn the call over to Jyoti Deshpande, CEO of Eros PLC. Please go ahead.

Jyoti Deshpande

Good morning everyone. Thank you for attending Eros International PLC's earnings call for the third quarter ended December 31, 2015. I'm first of all grateful to the Audit Committee, which is being assisted by Skadden in the ongoing internal review, for issuing the interim statement that just instil confidence in the market that we are a solid, credible company and the anonymous short selling campaign is baseless. As the Audit Committee said, once the review is completed in March, a further update will be offered. Which brings us to our business and operations.

The performance of our film slate has been nothing short of extraordinary this year. *Bajrangi Bhaijaan* stays foot as the undisputed number one in the box office. *Bajirao Mastani*, our big release from the December quarter raced to number three and *Tanu Weds Manu Returns*, which probably set new benchmark in return on investment, being a medium budget film retains number four position, even ahead of the much hyped big star cast films. So three out of the top four and seven out of the top 15 on the Indian box office in the calendar year 2015 are Eros films. A staggering market share, which allows us to reinforce our business fundamentals in a very emphatic manner.

What is important in these results beyond the numbers, are the underlying constructs. As the CEO, the most important consideration for me at this point in time is regaining credibility, capital allocation and focus on cash, so that the business, be it full slate expansion or Eros Now initiatives can operate as normal without being affected by market factors. Prem will be going through the financial results and MD&A with you, so I won't dwell on that. But let me run through the internal thought process. Our library of over 3,000 films which we continue to augment each year by adding new films, is our crown jewel. This library is being monetized worldwide across formats, when we license television or

cable rights in India or when we license foreign language dubbing or subtitling rights across distribution platforms in any of the 50 different countries that we operate in.
We had shared in the past that typically library monetization through multiple films bundled contracts account for 25% to 30% of our revenues and generally trend to be weighted in the second half of a financial year. You've already seen that pattern in financial year 2015 financials.

While individual contracts are not very large in dollar terms, they do aggregate to a significant amount and quarterly payment terms stretching across a year, means it would have added to the receivables number in the short-run, although it would have ended up in the "not due" bucket. Hence, given the recent attention around receivables, we are very much focused on hitting our target of $160 million for trade receivables. We have decided to actively hold back licensing a portion of bundled contracts with longish payment profile for one or two quarters, until we achieve the targeted working capital efficiencies and turn the corner by becoming free cash flow positive by the end of the financial year. This also allows our teams to put positive pressure on collections. Ultimately, it is like being caught between a rock and a hard place and we know we won't be able to please you all, but anyone who is familiar with the intricacies of our business will see the sense in short-term sacrifice of the P&L for a longer term robust balance sheet and cash flow.

Our film slate for FY17 is very robust. In fact two high budget films; *24* in Tamil and *Sardaar Gabbar Singh* in Telugu, which were to release this quarter have now shifted to Q1 of next year. Just for these two films alone, we have pre-sales visibility in excess of $20 million as we speak. Those two films, along with *Housefull 3, Rock On 2, Dishoom, Baar Baar Deko, Shivaay, Singam 3, Chef,* etc make it one of the most compelling slates in the market. What's more, this slate is substantially funded already.

Our Trinity Pictures initiative is tracking well. Two films that were developed in-house have been green-lit by our Indo-China partners and four other films, all written as franchises, will go on the floor this year across kids genre, animal genre, spy thriller and a buddy cop film. *Bajirao Mastani* will be releasing in China in Q1 next year, in what we believe is the widest ever release for an Indian film in China. We will unfold further details of that in separate press releases. Some of our other FY16 slate films such *as Dil Dhadakne Do* will also release in China.

Now for my favourite part of the business, ErosNow. Firstly, the 30 million registered users across WAP, App and Web was third-party verified as part of the internal review. So there is no shadow of doubt around their existence. And the number I'm pleased to say has now grown to over 37 million as of December 31, 2015. The focus is now on not just growing this base to a very large number out of the potential 1 billion plus mobile subscribers in India, but also converting a meaningful proportion into paying subscribers.

Looking at early trends of paying customers, we are confident, Eros Now can cross 1 million paying subs by the end of fiscal '17 and then start to gain some real momentum thereon. Our compelling consumer proposition is a combination of great content, with great product features at a great price and pushed across different distribution platforms. The Indian market is as much a business-to-business push by integration with various telecom partners and OEMs, as much as it is business-to-consumers through marketing pull. With digital rights of over 4,750 films available for Eros Now, it is one of the largest, if not, the largest Indian movie offering online.

With at least two digital premiers a month and a majority of the top five films of the year on ErosNow, including those films that were not Eros produced, makes it a compelling content offering. Over 200,000 audio and video tracks across 13 Indian music labels and cool, edgy, contemporary originals which are under constant development and user testing before launch.

Our new pricing has worked wonders and we can see the positive effect it is having on conversion to paid customers. At $0.77 and $1.54 per month premium packs, we pack a punch. In terms of features, we already offer portability across eight devices, video progression where a user can pick up where he left off across any device, high-definition and subtitles and our most anticipated feature which is offline viewing, which will go live in March. This is a game changer for India as this circumvents the issue of broadband speeds on data costs and allows the top-tier premium customer to download some of the DRM protected content on their device and watch it offline even when they're not connected to the Internet.

We recently announced a deal with LeEco in India. LeTV are the largest OTT platform of China and they sold over 5 million smartphones in China last year alone. We've struck a deal to integrate ErosNow and their smartphones and offer an annual free bundled subscription worth $1.10 and $1.20 on the basic and premium phone respectively. So far, LeEco has been a huge hit and garnered over 800,000 pre-registrations when we launched on Flipkart last month and are currently pushing flash sales. The LeEco system is a very smart technology platform and their operating system encourages stickiness without having to download an app. This deal will be extended to the LeEco smart televisions also. And we're excited to partner with them in India. These kinds of deals also encourage rapid conversion to the subscription model. 1 million paying subscribers target doesn't seem that challenging all of a sudden, but let's start with that for now.

Once again, I thank all those who believed in us. Some of our top shareholders have increased their shareholding in Eros, which is a great statement of credibility for us. We also thank our business associates and the wonderful team of Eros who have shown their strength in character in the last few months. Our confidence is that we will soon regain the market recognition for the intrinsic value in our business.

With that, let me turn the call over to Prem Parameswaran, our Group CFO, who will walk you through our financial performance in more details and then we'll open up the call to your questions. Thank you.

Prem Parameswaran

Thank you, Jyoti. Good morning and thank you for joining us again today. This quarter was about executing on our long-term growth strategy and solidifying our financial profile. During the quarter, we made significant progress, investing in a strong slate of content, building our international distribution opportunities, managing our receivables and positioning our business to generate positive free cash flow. I'll discuss these items in more detail throughout my commentary on the results.

Revenues for nine months ended December 31, 2015 were $209 million, which represents a growth rate of 7% over the year ago period. On a constant currency basis, our revenues grew 12% over the same period. Revenues for the three month period were $61 million, which represents a decrease of 40% over the year ago period. We faced a tough comp with last year's third quarter result, given we had only one high budget film, *Bajirao Mastani* in this quarter, versus three high budget films in the third quarter of fiscal 2015.

Our primary revenue streams are derived from three channels as most people know; theatrical, television syndication, and digital and ancillary. Over the nine-month period, we generated 57% of our revenues from theatrical; 22% from TV syndication; and 21% from digital and ancillary. As Jyoti mentioned earlier, we have intentionally deemphasized catalogue revenues in the third quarter and expect to do the same in the fiscal fourth quarter. This will allow us to focus on revenues with shorter collection profiles, increased cash collections and reduce our overall receivables balance. We are therefore still on track to be free cash flow positive for the full fiscal year-end 2016.

In line with the exceptional performance of our theatrical business, revenue from India increased to $34 million in three months ended December 31, 2015, which made up 56% of the total revenue for that period. Over the nine-month period ended December 31, 2015, revenues from India were $128 million or 61% of total Group revenue.

Cost of sales for the third quarter decreased to $42.9 million, compared to $45.1 million in the prior comparable period. The decrease is primarily due to a lower number of high budget films that I discussed earlier. For the nine months ended December 31, 2015, cost of sales increased to $129.4 million from $107.8 million in the prior comparable period. This increase was primarily due to an increase in amortization costs, taking into account the Company's new release slate for the period, as well as an increase in direct costs due to proportionately higher advertising and distribution costs and accrued overages in the co-production of various hit films. The decrease in adjusted EBITDA across both reported periods reflects the changes in cost of sales and in particular, the increased amortization charges as well as higher contribution of theatrical revenue and lower catalogue sales as mentioned earlier.

Now, looking at our balance sheet. Gross debt at December 31, 2015 remains largely unchanged at $316.6 million compared to $314.7 million at fiscal year-end 2015. We have cash and cash equivalents of $151.5 million currently on our balance sheet. We remain well-capitalized and believe our balance sheet is conservative. Over the nine-month period ended December 31, 2015, we generated $209 million of revenue and our trade receivables increased by only $10.5 million over that same period. That's important. Our trade receivable balance stood at $208 million as of December 31, 2015, which represents a decline of $3 million from the period ended September 30, 2015. Our target is to bring the overall trade receivables balance down from $208 currently to $160 million by fiscal year-end 2016.

Our statement of cash flows for nine months ended December 31, 2015 shows a net outflow of $1.8 million. We remain confident that we are on-target to becoming free cash flow positive by the end of 2016 financial year, through working capital efficiencies and by staying vigilant on our targeted new content spend of $225 million.
Thank you for listening and now I'll turn it over to Jyoti and we will take questions.

Jyoti Deshpande

Yes, thanks Prem. Thank you everyone for your patience and we'll take questions now.

Question 1: Ankesh Agarwala, Macquarie

Hi. This is Ankesh in for Tim. Two questions. First, can you please update us on your plans to release new original TV content on ErosNow and our new plans to monetize ErosNow outside of India? And then second, can you talk about whether -- what you are seeing in terms of what type of content Netflix is providing in India and whether you'd consider selling your content to Netflix? Thank you.

Answer: Jyoti Deshpande

Thank you so much for that question. So apart from the elaborated plans that we had already shared for Eros Now and all the originals which are on track to go live on Eros Now, we have given further updates in this -- we've given updates for four specific originals that we will be launching called *Flip*, *Lost*, *Smoke* and *Legacy*, all of which are fresh, edgy, contemporary, they talk to young India. We use the language called ‘Hinglish’, which is a lot of Hindi with a bit of English. So we talk the language of the youth and we've given a schedule of when these will be live. So along with the movie premieres which is the backbone of the Eros Now proposition and probably unparalleled with the kind of movie library we have, these originals are something that no one else is doing yet, which is localized for that market. So April-July-September and November is these new ones and then there are others in the pipeline. And we go through a rigorous sort of -- we test these concepts, we make a pilot, once we have the pilot, we go test it with a target group. We tweak it if we have to and then we produce the 13 or 20 episodes of the first season that we need to do. So it's not something that can be turned around overnight, but it has been in development now for over a year and is beginning to see rewards.

Now coming to your second question in terms of what Netflix is offering and what do we see there? So currently, you see a small bunch of Hindi movies and mainly there are Western shows which is on offer on the Netflix offering for India. And we think it's great for the category, great for customers to have more choice in terms of OTT platforms. So anything that a Netflix does or an Amazon Prime does or any of the other players do Hotstar, etc, will only help moving people away from linear television consumption to consumption through the OTT platform. But like-for-like, we don't think of them as competition, because their content offering is so different and the pricing is also so different, because it's clearly targeting a very super premium niche at the moment. So we think it's complementary and it's great for the category at this point in time.

<u>Question 2</u> - John Janedis, Jefferies

Hi. Thank you. Just maybe a bit of a follow-up there, Jyoti. As you know, there were some concern in the market around ErosNow's growth due to the Netflix entry and so, have you seen any impact on either registered or early paid sub growth relative to plan? And then maybe as a follow-up to that, assuming you hit the 1 million sub target there, where do you expect to source the subs and will you be giving a quarterly paid sub number going forward?

Answer: Jyoti Deshpande

So thanks for all those questions and if I forget to answer something, please come back and remind me that I've not answered that. But I think for starters, I think, we've put ourselves out there and we've monitored early monetization, our new pricing of $0.77 and $1.50 seems to have hit the sweet spot and we're seeing conversions to premium subs and I don't know, if it’s nice for me to say this, but what is great for us is, other products out there at $8 offerings makes our products look even better, because customers are getting more bang for their buck for under $2. So it's probably helping us in more ways than we imagined. So we feel pretty confident about putting that 1 million subscriber -- paying subscriber number out there and what we haven't decided is that if we're going to update where we are against that every quarter, but we'll try and give you more and more colour as we get -- go more and more into the year.

Further question

Okay, thanks for that. And then separately for Jyoti or Prem. I understand the discussion on the receivables and holding back catalogue and then I appreciate the comments that you can't please everyone, but can you give us a little more detail on the revenue impact and is there a risk that buyers go elsewhere and fund a long-term replacement for the content?

Answer: Jyoti Deshpande

I'll take this one. No, actually. So the buyers going anywhere and finding long term replacement meant for the content is not a risk purely because the kind of library that we have is simply unparalleled and the way we do these bundling contracts is, if you're doing a 20 film deal or a 25 film deal, you will put at least three or four films that are current and new and the rest of the films will be from the previous year. So everyone wants your top 15 films and if they could just easily have it, then the pressure to catch up on their payments is not as high. So it's something that we don't think is going to be too long drawn out. We have our sights on it and we think in one or two quarters, the situation will normalize.

So we had a choice of -- we already beat what was our internal revenue target. So because we had an extraordinarily performing new release film slate, we actually could do this. Otherwise, we would be back in the market explaining why receivables are not down. So we take this opportunity to actually catch the bull by its horn and say, okay, now we're doing this for one or two quarters, our new release slate has performed well, we actually can do this and then we go back to normal.

Further question

Thanks, maybe one other quick one. Can you update us on the cost for a season of originals, meaning, I think you've talked in the past that it was low cost for the season and I was wondering if that has changed at all?

Answer: Jyoti Deshpande

No, that has not changed. So nothing is more than couple of million dollars for a whole season. So I think, the most expensive would be like $2 million for the whole season.

<u>Question 3</u> - Eric Katz, Wells Fargo

Hi, good morning. Nice to see the guide for the paid subs by the end of fiscal '17. I was wondering if you could tell us what the current paid subs are or if anything, how much are premium subscribers and what gives the confidence in the trends to hit the 1 million by fiscal '17? Anything qualitative or quantitative would help.

Answer: Jyoti Deshpande

Okay, thanks for that, Eric. And I think we sort of said less than 1% or under 1% of our current registered users are paid subs. So that should give you some sense of where we are now. But I've talked about in my speech and it's in the press release, deals like the LeEco deal where we're preloading our deals with AirTel. AirTel has been live for some time now and we're seeing that is tracking and if you went to India now, there would be billboards which AirTel is taking with ErosNow on it, so they're actively promoting ErosNow on AirTel and things like that. So I think, this is a good time to sort of remind everyone that unlike the Western model where it's a business-to-consumer model and really it’s up to the consumer, to put your credit card details and subscribe to a Netflix or an Amazon or any of those services, in India, it's equally distribution, integration with OEMs and telcos and all those deals that help you get paying subscribers. So looking at where AirTel is going, looking at deals like LeEco where our service is preloaded with an annual subscription on those smartphones and we see them flying off the shelves, we think that's just the beginning. And apart from this, you will have a B2C push when all our originals come on board and when our features come on board and actually we're being prudent with our marketing dollar and we are getting customers without having to spend huge dollars on marketing those.

Further question

Okay, that's interesting. As far as the internal review, is there anything you can tell us about the process and when you say “the advanced stages”, what exactly do they have left to review only because it's been a few months now?

Answer: Jyoti Deshpande

Sure. So I think, what we're allowed to say at this point in time is that, it's a pretty comprehensive internal review that has swept a number of topics that were out there, which is why it's taken the time that it has. But what the interim statement is designed to do is to signal that, there is nothing of concern so far and it's going on track and they need to complete that process, when we can give you a further update on any other colour or the scope or what it involved or who it involved.

Further question

Okay and just one last question. I assume when you gave the receivables target before, you weren't necessarily planning on holding back the content. So is there a reason you can’t collect and still elaborate at the same time and I also believe in the last call you mentioned that it was $20 million or so of receivables collected in fiscal Q3 at the time of the last call. So if you can explain, maybe just the inflows and outflows in the quarter and so how you get to an almost similar receivable balance that would be helpful. Thank you.

Answer: Jyoti Deshpande

Okay. So what we're trying to say about the receivables is that, when you do the catalogue sales and the reason why we need to hold back is, if you added $20 million of catalogue sales say in the December quarter, only a very small portion of it would be due in this financial year. So that 20 million would go and add to your receivables number, and then, it would sit in the "not due" ageing market, but it would still add to your overall receivables. And that was the logic behind -- so nothing has changed in the market in terms of the kind of terms customers would enjoy for these types of rights and stuff like that. So hence it is prudent to sort of, hold back that profile of revenues for a couple of quarters, till you bring down the receivables to the levels that we've targeted, which is $160 million number.

Now, so for example, Q3, so in the first nine months of the year, we've added over $200 million of revenue. And if you compare the receivables between March '15 and now, the receivables only increased by $9 million or $10 million. So which means we're substantially catching up with the old receivables and what you see, so if *Bajirao Mastani* released on December 18 and we only got in couple of weeks of theatrical revenues and some other revenues in that quarter -- for the December quarter, so much of the December quarter revenues will be collected in the Q4 and won't go beyond. So we feel confident that the new release revenues of Q3 and Q4 we will substantially collect and we will catch up on the old collections, so that we then come on track and we can do business as usual from Q1 of next year.

Closing remarks: Jyoti Deshpande

Once again, thank you very much for having faith in our company, for being interested, for asking all these questions. We feel very confident that we will overcome whatever little crisis that we had to go through over the last few months and we will emerge a winner. Thank you once again and if anyone has any other questions, we are happy to take follow-up questions later. Bye.