
Research Analyst

Akash Jain – MBA (Financial Markets)

Regd. Off. : 101, Samarth, Off. Hinduja Hospital, LT. P.N. Kotnis Road, Mahim (West), Mumbai - 400 016. Tel : 91-22-40280400, 24460335
mail : ajconresearch@ajcon.net Website : www.ajcononline.com

*Eros International Media Ltd. (EIML) – RA. ONE to add fuel….* *24th October, 2011*

| | |
|---|---|
| NSE/BSE Code | EROSMEDIA/533261 |
| Promoter's holding | 78.12 % |
| FV | Rs. 10 |
| Equity Capital (Rs. in mn) | 914.07 |
| Networth (Rs. in mn) | 6,705 |
| Market Capitalization (Rs in mn) | 23,855 |
| 52 week high/low | Rs. 277 (18th Oct, 2011)/Rs.124.3 (23rd March, 2011) |
| CMP | Rs. 268 |
| **Target Price** | **Rs. 349** |
| Upside | 30% |

***EIML is one of the market leaders in the Indian film industry and has been one of the pioneers in taking Indian films to the global audiences by leveraging its well-established distribution network. Being part of the Eros group, it enjoys strong parentage. Eros group has three decades of experience in its domain. The group went public, through Eros plc, (the holding company of the Eros Group), through Alternative Investment Market (AIMs) of the London Stock Exchange. EMIL is engaged in sourcing Indian and other film content. It exploits its content globally, through its offices in India, UK, USA, UAE, Singapore, Australia, the Isle of Man and Fiji. Presently, the company has an extensive and impressive film library of 1,100 plus strong library of Hindi, Tamil and regional language films. Its distribution formats includes theatres, home entertainment, television and digital new media. In FY 11, EIML successfully released a total of 77 films across various languages, reiterating its leadership position in the Indian film industry. In the same period, the company successfully completed the listing of its shares on the Indian exchanges. It raised Rs. 3,500 mn through Initial Public Offer of its shares. The issue price was kept at Rs. 175/- per share including a premium of Rs. 165/- per share. The issue got a overwhelming response and was subscribed 29.9 times.***

***The company registered impressive revenue CAGR of 47% over the period FY06-11 while PAT CAGR over the same period was robust at 128.4 %. In FY11, the company witnessed topline growth of 10.3% on yoy basis. This was mainly on account of company's robust and dynamic business model with a de-risking strategy of pre-licensing its film content for maximum monetization. Box office success rates (Housefull, Golmaal 3, Endhiran and Dabangg) have also significantly contributed to the increase in the topline. At CMP, the stock currently trades at a P/E of 20x at FY11 EPS. We believe, the Group's recent marketing efforts at the Cannes film festival is expected to open new markets for its films, which will progressively unlock the value of the film library. EIML is a major beneficiary of the opportunity present in Indian Media and Entertainment sector. With due consideration to factors like a) strong slate of movies like RA ONE, Desi Boyz, Rockstar, Cocktail, Rana etc, b) expected blockbuster revenues from upcoming release of RA. ONE in the festive season of Diwali - 2011, c) rights of over 1,100 films, d) unique and derisked business model, e) end to end distribution network, f) strong regional presence, g) television syndication strategy to augur well for the company, h)*** **Clear visibility of revenues for television and music for next two years through pre-licensing underpinning the significant portion of slate cost and minimizing the overall risk profile, we recommend a 'BUY' with a target price of Rs.349 (18x at FY13E EPS) for investors with a nine months horizon.**

***Financial summary***

| Particulars | FY09 | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|---|
| Net sales | 6,265 | 6,409 | 7,070 | 8,484 | 9,841 |
| YoY growth (%) | 32 | 2.3 | 10.3 | 20 | 16 |
| *EBITDA (%)* | *18.3* | *20.2* | *23.8* | *24.5* | *26* |
| PAT | 733 | 821 | 1,172 | 1,442 | 1,771 |
| *PAT (%)* | *11.7* | *12.8* | *16.6* | *17* | *18* |
| EPS | 8.01 | 8.98 | 12.8 | 15.7 | 19.37 |
| P/E(x) | 33 | 29 | 20 | 5 | 13 |
| ROE(%) | 46.4 | 34.8 | 17.6 | 18.5 | 19.8 |

*Source: Company, Ajcon Research (FY12 and FY13 projections based on conservative street estimates)*

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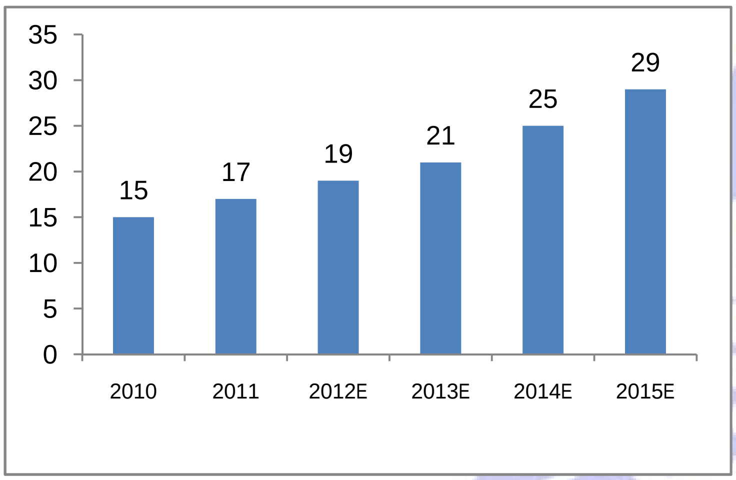
## Investment Rationale

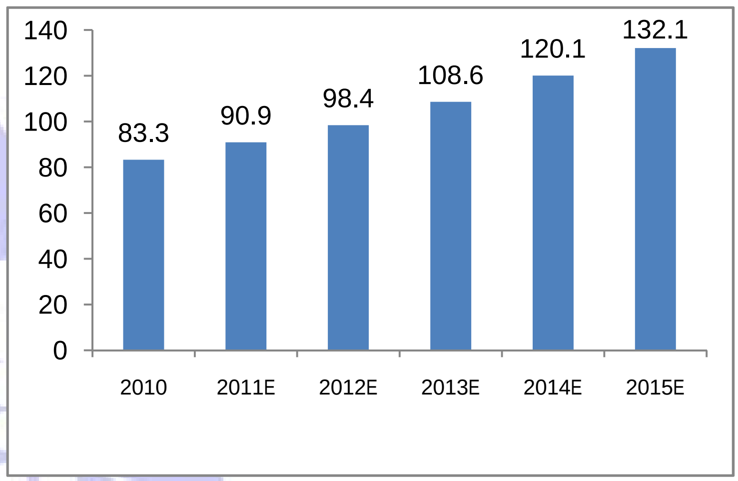
**Strong sector fundamentals:** Indian media industry has been one of the fast growing sectors in the economy on the back of India's young population propensity to spend on discretionary income. Per capita income has registered a CAGR of 7.2% to US$ 747 in 2008. The industry is expected to clock a CAGR of 14.3% till 2015 driven by increasing regionalization, digitization through new distribution platforms like Digital Cable, DTH, IPTV, distribution and sale of media content online. Indian film industry, part of Indian Media and Entertainment industry is one of the largest in the world, producing more films and selling more tickets than US film industry. Considering factors like increasing multiplex screens, improving penetration of home video segment; the industry is expected to witness a CAGR of 9.7% over the period 2011-2015E to Rs. 132.1 bn.

**Indian Media and Entertainment Revenue Outlook (US$ bn)**




Source: Company, Ajcon Research

**Size of Indian Film Industry (Rs in bn)**




*Source: Company, Ajcon Research*

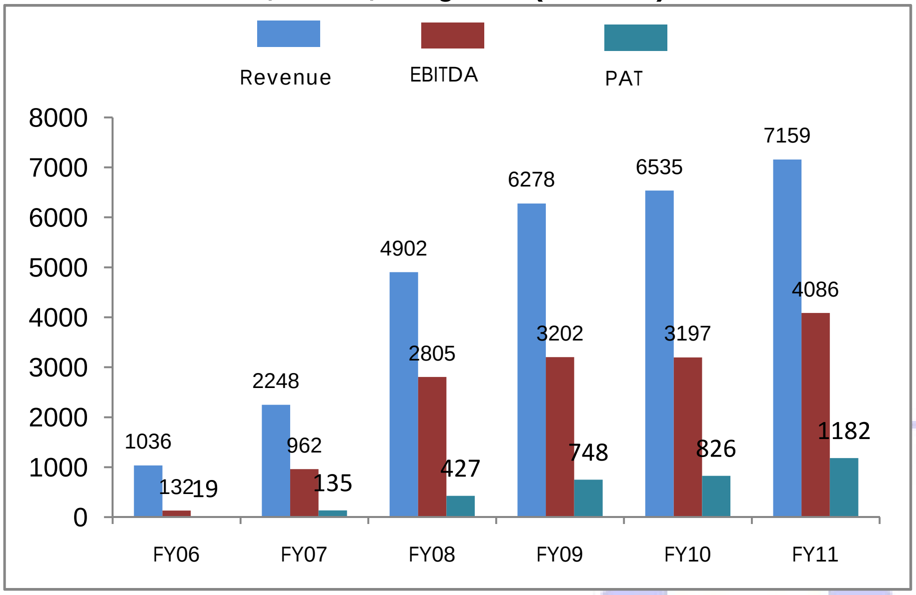
**Revenue stream of Indian Film Industry (Rs in bn)**

| Particulars | 2010 | 2011E | 2012E | 2013E | 2014E | 2015E | CAGR (%) |
|---|---|---|---|---|---|---|---|
| Domestic Theatrical | 62 | 67.4 | 72.2 | 79.2 | 87 | 94.8 | **8.9** |
| Overseas Theatrical | 6.6 | 6.7 | 7.2 | 7.9 | 8.7 | 9.5 | **7.6** |
| Home video | 2.3 | 2.5 | 2.6 | 2.8 | 2.9 | 3.0 | **5.5** |
| Cable and Satellite rights | 8.3 | 9.6 | 11 | 12.6 | 14.5 | 16.6 | **14.9** |
| Ancillary revenue streams | 4.1 | 4.7 | 5.4 | 6.2 | 7.1 | 8.2 | **14.9** |
| **Total** | **83.3** | **90.9** | **98.4** | **108.6** | **120.1** | **132.1** | **9.7** |

*Source: Company, Ajcon Research*

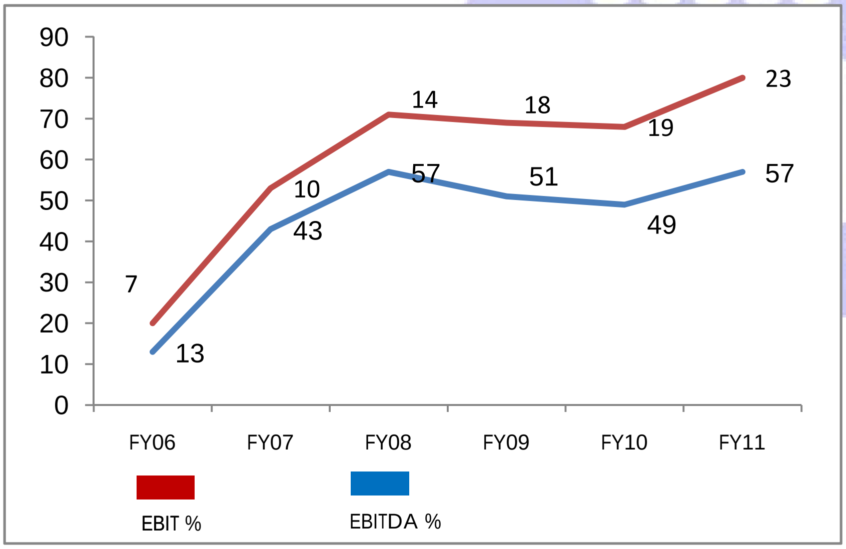
## Impressive financial performance:

**Standalone Revenue, EBITDA, PAT growth (Rs. in mn)**




*Source: Company, Ajcon Research*

**Standalone EBIT and EBITDA (%)**




*Source: Company, Ajcon Research*

**Unique and Derisked business model, end to end distribution network**

EIML sources it content either through acquisition mode or the co-production mode. It prefers this model as it is able to work on more than one production rather than having significant in-house production. The company either acquires the film from the producer at various stages of production for an agreed contractual value or co-produces the film from inception as per the agreed terms. The company acquires films and enters into co – production arrangements that ensure access to superior content at financially attractive terms.

| Typical acquisition arrangement | Typical co – production arrangement |
| --- | --- |
| Early acquisition of film at a negotiated price | Pre-agreed budget, star cast, script and co – producer |
| 15-20 year rights | Intellectual property rights in perpetuity |
| First position recoupment of entire Minimum Guarantee Price, followed by all print and advertising costs, followed by a 20% fixed profit on all gross revenues and the remaining profit is shared in pre – agreed ratio. | Fixed production fee and over-budget cap |
| | First position recoupment of entire investment, followed by all print and advertising costs and a 20% fixed profit on all gross revenues and the remaining profit is shared in pre agreed ratio. |

*Source: Company*

**End to end distribution network**

EIML is one of the few companies within the Indian media and entertainment sector to have an end-to-end (all format) distribution capability. The chain includes national theatrical distribution network, in-house music distribution capability with its own music record label, Eros Music, an in-house television syndication team, and its own home entertainment distribution division

**Derisking**

As a strategy to mitigate the overall risk profile and increase the visibility of revenues it continues to pre-license television, music and digital rights well in advance. Given the largest visibility and the strength of its slate of movies the company derives and secures attractive prices thereby underwriting the significant portion of the slate cost.

**Content monetization**

EIML generally monetizes each new film it releases through an initial 12-month revenue cycle commencing after the film's theatrical release date. Thereafter, the film becomes part of its film library, through which it continues to monetize the content on various platforms providing a source of recurring cash flows. The company distributes a film through all platforms, i.e. theatrical release, television satellite, home video, and new media and music rights. EIML derives 50-60% of revenues from big budget films. The company follows the Studio approach in its movie production and distribution business. It de-risks its movies' box-office performance by pre-release selling the satellite and music rights, thereby recovering about ~50% of its production costs. For instance, in Hollywood, 70 per cent revenues are secured before the film's release, and the dependence on the response in theatres is only 30 per cent. As per film trade analysts, there had been a huge shift in India as well over the past six months, with the dependence on theatres coming down to 45 per cent, and the rest from satellite (30 per cent) overseas (20 per cent ) and others (5 per cent). According to the management, EIML pre sells the maximum rights on pre release from satellite (30 percent), overseas (20 percent) and others (5 percent). According to the management, the company recovers 40-80% of the cost before the film is released.

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## RA. ONE to add fuel...

For its latest upcoming blockbuster, the company along with Red Chillies Entertainment has brand tie-ups worth Rs. 520 mn for the highly anticipated movie *'RA.ONE'*. The movie is expected to be India's best marketed film via a 360 degree global campaign with record breaking number of brands on board. EIML and Red Chillies have already recovered a major portion of their investments through in-film branding, media endorsements and through pre-licensing to Cable & Satellites, music and other rights.

According to Film trade experts RA ONE has been produced at an estimated budget of Rs. 100 crore with an additional spend of Rs. 15-20 crore on marketing is expected to rake in revenues anywhere between Rs. 250-270 crore from multiple streams, including domestic theatres, overseas distribution, satellite and music rights, digital and home videos, merchandising and gaming.

According to media reports, Ra.One's domestic box office collection is estimated to be R100 crore in the five-day opening weekend, starting Diwali. "The festive weekend and Shah Rukh's star power could result in Rs. 100 crore in revenue in the opening weekend. The following two weeks could yield an additional R40-50 crore, as the film will enjoy a clear run at the box office, with no other major releases.

Based on track record of Mr. Shahrukh Khan starrer film, we expect collections of Rs. 45-50 crore from foreign markets. Shah Rukh's last film "My Name Is Khan" earned Rs. 40 crore from overseas market. We are expecting a 15-20% increase in collection from overseas theatres for RA.ONE. The film would be released across 3,000 screens in India and abroad, of which 500 screens will be 3D which would result in higher recovery.

Besides theatrical revenue, RA. ONE is poised to collect about Rs. 70-75 crore from alternate streams. According to people familiar with the broadcaster, Star India has won the satellite rights of the film for Rs. 35 crore, while T-Series has paid Rs. 15 crore for the music rights. In addition, Sony Computer Entertainment Europe (SCEE) has partnered with Red Chillies to develop a PlayStation game on the movie. Ancillary revenue streams are expected to yield about Rs.12-15 crore for the producers.

As per Atindriya Bose, country manager at Playstation, the company has dished out ~Rs4.8 crore to develop the RA. ONE game on its PS2 and PS3 platforms, as well as advertise the product to appeal to consumers.

### Healthy balance sheet

EIML is cash rich company with cash on books of Rs. 1.5 bn as on FY11. The company does not need any kind of funding, as the upcoming releases lined up in Q3FY12 and Q4FY12 are all high profile films (Ra One, Agent Vinod, Desi Boyz and Rockstar) which is expected to provide hefty returns. Those films are expected to generate significant cash flow. So, this implies that EIML is sufficiently funded and have internal accruals, which will help them in terms of further investments into content.

### Television audience to create additional stream of revenues

We believe India's television audience creates new opportunities for EIML to license its film content, enhancing its brand visibility and recognition. The value of license fees that television networks are prepared to pay for licensing television rights has increased due to a highly competitive television market, boosted by pay TV and subscription growth and ever-increasing demand for premium content. It covers a significant percentage of film costs. The visibility of television earnings is clear due to the strength of the future pipeline of films. Its strategy of successfully pre-licensing films to television networks for future broadcast will continue to mitigate the Company's overall risk profile.

Its television syndication strategy is driven by licensing new film releases and Eros India Library films to television channels as a bundle. Furthermore, the revenues generated from the exploitation of films from its library have high margins because a substantial proportion of the cost of films in the Eros India Library is written down within the first few years following their theatrical release. We believe that the Eros India Library will be able to generate stable revenue streams as new distribution platforms continue to evolve. The Eros India Library also allows the company to take advantage of technological developments and re-monetize the same films across different formats as technologies advance over time. For example, in the past, it has monetized the same films over a period of time on video format, VCD, DVD, DTH, IPTV, cable. The Eros India Library allows EIML to maintain and further develop diversified revenue streams thus reducing its reliance on theatrical revenues.

### Competitive advantage in monetization through new and emerging media platform

We believe that the company will be able to benefit from the experience of the Eros International Group in digital exploitation, such as DTH, video on demand and IPTV platforms, to ensure that it can take advantage of the growth of these emerging revenue streams.

For example, the Eros International Group has been able to monetize its library content on international markets through formats such as branded subscription video-on-demand services on cable platforms such as Comcast Communications LLC, Cablevision, Rogers Broadcasting Limited and other platforms in the United States. This has been possible as a result of monetizing a combination of new films and existing films from the Eros International Group's catalogue of films. EIML intends to position itself to take advantage of similar technological opportunities in India and leverage Eros International Group's international experience to maximise its impact. We believe the increased distribution of films in Blu-Ray format and the expansion of corporate bundling deals will add depth and scale to its home entertainment strategy. We believe that digital convergence, technological developments and the popularity of mobile content will present new opportunities to diversify its revenue streams and exploit the Eros India Library. The company aims to own all the intellectual property rights to a film instead of having fragmented rights to different aspects of the film.

### Strong slate of movies ensures revenue visibility

| Film Name | Star Cast/Director | Production House | Tentative Release | Status |
|---|---|---|---|---|
| RA. One | Shah Rukh Khan, Kareena Kapoor, Arjun Rampal (Anubhav Sinha) | Red Chillies Entertainment | October 2011 | Post Production |
| Rockstar | Ranbir Kapoor, Nargis Fakhri (Imtiaz Ali) | Shree Ashtavinayak Films | November 2011 | Post Production |
| DesiBoyz | Akshay Kumar, John Abraham, Deepika Padukone (Rohit Dhawan) | Next Gen Films | November 2011 | Post Production |
| Agent Vinod | Saif Ali Khan, Kareena Kapoor (Sriram Raghavan) | Illuminati Films | December 2011 | Principal Photography |

| | | | | |
|---|---|---|---|---|
| Rana (Hindi, Tamil and Telugu) | Rajnikanth, Deepika Padukone (K.S. Ravikumar) | Ocher Studios/Next Gen Films | FY13 | Principal Photography |
| Cocktail | Saif Ali Khan, Deepika Padukone | Illuminati Films/next Gen Films | FY13 | Principal Photography |
| Kunal Kohli – Untitled | Shahid Kapur, Priyanka Chopra | Kunal Kohli Productions | February 2012 | Principal Photography |

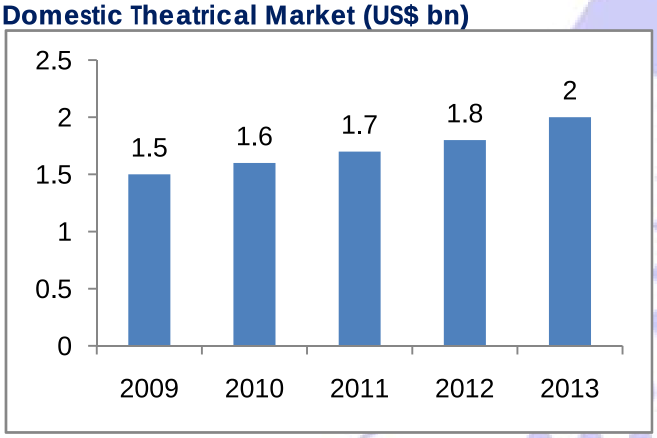
*Source: Company*

In the second half of FY2012, the company has lined up big releases like RA One, Rockstar, DesiBoyz and Agent Vinod. Considering the starcast, directors, the movies has already created a huge buzz among the general public leading to higher viewership interest.

## Snapshot of theatrical market

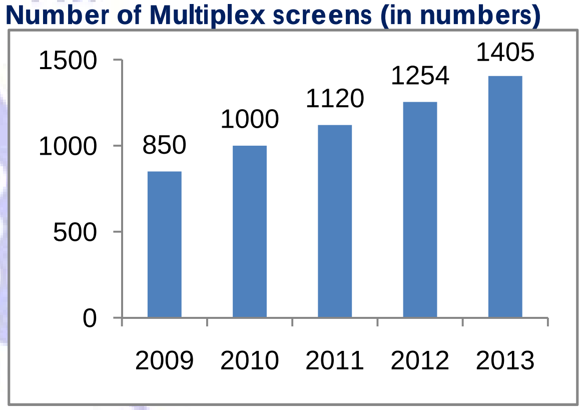
a) India is the second largest cinema entertainment market with over 1,000 releases every year
b) Around 3.2 bn movie tickets sold are every year versus 2.2 bn in the US
c) Potentially, 100,000 screens are needed to service the population. However, there are only 13,000 screens, of which only 3,000 are serviceable
d) A trend towards digital screens (built on refurbished run – down single screens) will be a significant driver for the market growth
e) The highly under penetrated Indian Media and Entertainment industry provides a reassuring platform for growth especially in terms of theatricals, resulting in aggressive multiplex growth and a rise in average ticket prices.

**Domestic Theatrical Market (US$ bn)**



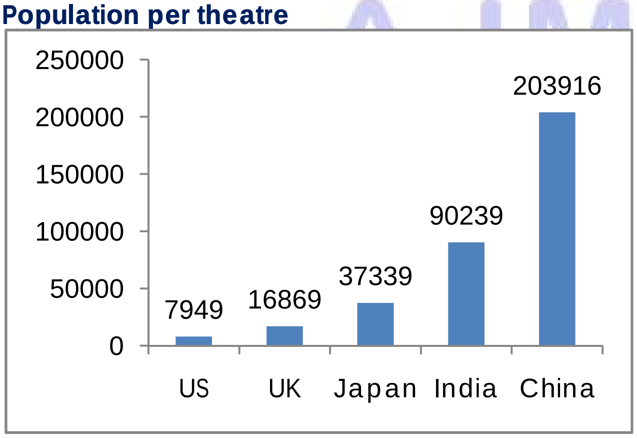

*Source: Company, Ajcon Research*

**Number of Multiplex screens (in numbers)**




*Source: Company, Ajcon Research*

**Population per theatre**




*Source: Company, Ajcon Research*

## KEY EXTRACTS: INTERVIEW WITH MR. KAMAL JAIN, CFO: EROS INTERNATIONAL MEDIA

1) **What is your expectation on the upcoming movie "RA ONE". How much revenues the company expects? RA One is considered as one of the most costly film? How confident is the company on recovering the cost? Could you brief us on the monetization process of this movie through various options? How much of the cost of the movie has been booked so far?**

   As far as cost of RA.ONE is concerned, it's sub Rs 100 crore a film. On an average EIML, covers 40-80% of the cost before the movie comes to the theatre. So, most of the monetization streams like satellite, music, have been already monetized. For RA. ONE is percentage is slightly higher at 50-60%, considering it is one of the biggest anticipated film of the year and the entire nation is waiting for this film. We are planning a very big release on 3,000 screens across the world.

2) **Considering the media reports, the recent film "Mausam" did not go well with the critics? In terms of business, how has been the movie's performance in terms of ticket sales, incremental gains in terms of music rights, merchandising rights and etc?**

   A: This film was released on more than 2,000 centers across the world. Moreover, it was a very economically budgeted film. It's already a profitable venture for us with profit margin of 15-20% because of our de-risking strategy to pre-license website and other monetization revenues of the film.

3) **On a bull case scenario, street expects "Eros International Media" to achieve a turnover of ~ Rs. 900 cr in FY12E and Rs. 1,100 cr in FY13E with Net Profit of Rs. 150 cr in FY12E and Rs. 190 cr in FY13E? How confident is the company to achieve that?**

   We are very confident considering the slate of upcoming movies in the coming two quarters and FY13. In addition to RA ONE, there is Desi Boyz and Rockstar, which are other big films releasing for us. Plus, we have couple of films releasing in the fourth quarter as well. So the numbers, which have been slated, are quite achievable as far as FY11 and FY12 are concerned.

4) **As the company follows a derisked business model, what is the likely revenue mix for FY12 and FY13 in terms of Sale of rights (Music, satellite, television and theatrical release)?**

   40% comes from box office/theatrical release, satellite rights account for 25%, overseas rights form 25% of total revenues and the balance 10% is accounted by misc (Music, new media or digital platform rights).

5) **What is the company's strategy in terms of amortizing the film rights? What factors the management considers in deciding the term of amortization?**

   We write off 72% in the first year and the balance is amortized over a period of nine years.

6) **What is the company's capex plan for FY12E and FY13E and how would the overall working capital cycle look like considering the monetization process?**

   Estimated capex plan is Rs. 11 bn in total for FY12E and FY13E. Our overall working capital cycle is of 90 days.

## ABOUT THE COMPANY

EIML having experience of over three decades is a global player within the rapidly expanding Indian media and entertainment arena. It operates on a vertically integrated studio model controlling content as well as distribution & exploitation across all formats globally, including cinema, digital, home entertainment and television syndication. Eros International is part of Eros International Plc which is the first Indian media Company to get listed on the Alternative Investment Market of the London Stock Exchange. The Company has a competitive advantage through its extensive and growing movie library comprising of over 1,100 films which include Hindi, Tamil and other regional language films for home entertainment distribution. Eros International has successfully built a robust and dynamic business model by combining the release of new films every year with the exploitation of a valuable film library, making it undisputedly one of the largest content owners in the business. The Group also includes a visual effects studio named EyeQube that provides production planning and visual effects services for films and the Group includes Ayngaran group of companies which is involved in the acquisition, production and distribution of Tamil films worldwide

**Business Model:**

| | Execution Role | Creative Control | Cost | Scalability |
|---|---|---|---|---|
| Acquisition | Low | Low | Market Value | High |
| Co -Production | Moderate | Moderate | Cost plus Arrangement | Moderate - High |
| Own Production | High | High | At cost (can overrun) | Low |

*EIML's core competencies*

**Key operational highlights**

a) Successful completion of IPO in October 2010, being subscribed 29.9 times through which the Company raised Rs. 3,500 million.

b) Released a total of 77 multilingual Indian films across Hindi, Tamil and other regional languages. Theatrical success of the portfolio of releases in the year notably Housefull, Golmaal 3, Endhiran and Dabangg. Five Eros films feature in the Top 10 box-office hits of the year published by Boxoficeindia.com for calendar year 2010.

c) Revenue growth driven by underlying market growth, box-office success of some of its film slate coupled with strong television syndication. EIML has a clear visibility of revenues for television and music for next two years through pre-licensing underpinning the significant portion of slate cost and minimizing the overall risk profile. Content investment touched Rs. 5.4 bn Million vis-à-vis Rs. 2.6 million last year, demonstrating a commitment to further growth and the largest slate visibility for FY 2011-12 and FY 2012-13.

d) EyeQube, the VFX facility, is actively focusing on prominent Indian film projects including Shahrukh Khan starrer RA.ONE and some prominent Hollywood projects.

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