Shemaroo Entertainment Ltd (NSE Code – SHEMAROO) – Alpha/Alpha + stock report for Jan'18

Content Index

Company Snapshot (21st Jan'18)

Rating – Positive – 4% weightage; this is not an investment advice (refer rating interpretation).

CMP – 497.10 (BSE); 498.70 (NSE)

Dividend yield – 0.28%

BSE Code – 538685; **NSE Code** – SHEMAROO

Market capitalization – Rs 1,353.00 cr.

Total Equity shares – 2.72 cr.

Face Value – Rs 10.00

52 Weeks High/Low – Rs 595.00/316.55

Particulars (in cr.)	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17
Income from operations	154.93	180.52	213.32	263.34	323.45	374.83	414.75
Gross profit	54.57	75.42	86.72	96.3	120.61	151.44	179.7
Gross profit margin (%)	35.22%	41.78%	40.65%	36.57%	37.29%	40.40%	43.33%
Op expenses as % of revenue	-14.42%	-16.25%	-13.75%	-11.60%	-10.19%	-10.91%	-12.55%
Operating Profit	32.23	46.09	57.38	65.75	87.66	110.53	127.65
Operating profit margin (%)	20.80%	25.53%	26.90%	24.97%	27.10%	29.49%	30.78%
Other Income							
Interest income and other income	2.03	5.10	1.35	0.73	1.26	2.10	4.75
Finance charge	-15.33	-19.21	-18.31	-19.23	-21.21	-22.83	-32.32
Depreciation	-2.71	-2.94	-2.98	-2.96	-3.67	-3.69	-4.16
Profit Before tax (PBT)	16.22	29.04	37.44	44.29	64.04	86.11	95.92
Profit After tax (PAT)	12.99	21.02	24.68	27.84	41.81	55.43	61.68

Introduction

In India and world over, streaming music and watching videos are increasingly becoming the most popular forms of entertainment. Look around yourself, kids, parents and even grandparents are now getting a feel of smart phones and their favourite past time is watching videos on Youtube or any other platform.

As per one of the articles in ET, in Sep'16 there were less than 200 million mobile internet users who, on average, used less than 500 MB of data a month. Cut to November 2017: there were close to 350 million mobile internet subscribers, using an average of 4 GB of data per month. This surge in data consumption is expected to continue and as per industry estimates, may reach 11 GB per month by 2020.

Considering the burgeoning video data consumption and looking at the various listed players, we believe the best way to capitalize on the opportunity is through Shemaroo Entertainment Ltd.

Over the years, Shemaroo has built a vast library of hindi films, regional titles and other special interest content and distributes the same over various media platforms including Television (satellite, terrestrial and cable television), New Media (such as mobile, internet and OTT) and Home entertainment.

What we like about the company is the fact that with changing times promoters have been able to transform their business; further unlike one of our past recommendations EROS International, we believe the accounting policy of Shemaroo is much more transparent and conservative and lastly considering the growth runway ahead the valuations look reasonable to us at around 21 times earnings.

Understanding Business and Company

Shemaroo's business in one line is about acquiring content and then monetizing the same by distributing over various platforms.

What kind of content does the company acquire?

Considering the fact that movies have longer shelf life, Shemaroo primarily focuses on acquiring movie titles from producers. Over the years the company has built a library of 3500+ titles covering around 1800 hindi films, 1400 regional titles and around 280 Special interest (kids, devotional, etc) titles.

Sr. No.	Types of Content	Perpetual Titles	Aggregated Titles	Total Number of Titles
1.	Hindi films	443	1,423	1,866
2.	Regional Titles	456	984	1,440
3.	Special Interest content	49	230	279
	TOTAL	**948**	**2,637**	**3,585**

Source: Shemaroo Entertainment's Investor Presentation

Now, acquiring movie titles is a risky business, especially pre-release transactions are very risky because the fate of the movie is unknown and even if the movie does well on box-office, it may not garner enough eyeballs on TV premiere. However, Shemaroo follows a slightly differentiated approach as it participates in second and subsequent cycles of film monetization.

First cycle of film monetization consists of box-office sales, television and overseas release revenue and is generally for a period of 5 years (5 years largely on account of TV rights and other OTT platforms because box-office life cycle is very small). Shemaroo acquires the movie rights in second and subsequent cycles as complete ownership/perpetual rights or limited ownership/aggregate rights.

By the time the second cycle starts the acceptability of the movie is already known and thereby slightly easier for the management to decide the cost of the content.

As far as Perpetual and aggregate rights are concerned, they differ in terms of limits on ownership of titles. While in the case of perpetual rights the company gets complete ownership for distribution across all geographies, platforms and perpetual periods, in case of aggregate rights, there's limit to period of usage (generally 5 years), platforms, geography or a combination of the above.

Since the last few years the focus of the management has been on acquiring perpetual rights because firstly there's no restriction of distribution on any particular platform (especially digital platforms) and secondly while the complete cost of the title is written off over a period of 10 years, the company can continue monetizing the titles even after 10 years.

Out of 3500 + titles the company owns 948 perpetual titles.

How does the company monetize its content?

Well, in order to monetize the content the company distributes it over several mediums including Traditional media such as broadcasting channels, cable networks, DTH, VCD, DVD, in-flight, etc and Digital media such as MVAS (mobile value added services), Youtube and other OTT platforms.

As the company acquires the content in later cycles, it doesn't own the latest blockbuster movies, and it is generally believed that there may not be much demand for such movies, be it on any platform; however as far as traditional media goes, the content provided by Shemaroo acts as filler content for a lot of movie channels because in a day around 8 movies are played and not every movie played is the latest or blockbuster. Similarly, while the movie may have performed average or flopped at the box-office, it may get decent audience on the TV.

Besides broadcasters, Shemaroo also partners with major DTH and cable operators to launch subscription-based, ad-free content services across various genres such as movies, devotion, comedy and regional.

It is important to note here that in Indian television industry, movie as a genre is second in terms of viewership after general entertainment channels (GECs) and with increasing number of both hindi and regional movie channels, the requirement for movie titles continues to increase.

In the new media space, again, contrary to the belief, one doesn't necessarily have to watch the entire movie and here Shemaroo has the added advantage of slicing and dicing content and repackage it in different ways like comedy scenes, songs, imagery, etc.

On new media platforms the company caters to all types of revenue models like pay per transaction, subscription, advertisement supported (free to consumer) etc.

As far as growth is concerned, in the traditional media segment the company has recorded 14% + CAGR in sales in the last 5 years with FY 17 recording only 3.5% growth. Demonetization did impact the growth as advertising revenues on TV got impacted; however going forward management is hopeful of growth returning back to double digits as revival in ad spends has been good.

New media segment is expected to be the major growth driver for the company though it has already been growing at a very good pace. Increasing smart phone penetration, increasing data and more specifically video data consumption, increasing number of OTT platforms are all pointing to the fact that there will be huge demand for video content in the years to come and that monetization rates will also improve with advertiser's increasingly adopting digital medium.

Since FY 12, digital media revenue for Shemaroo has recorded 44% CAGR with 45.35% growth in FY 17 and management is hopeful of maintaining 40% + CAGR for the foreseeable future.

Media Industry outlook

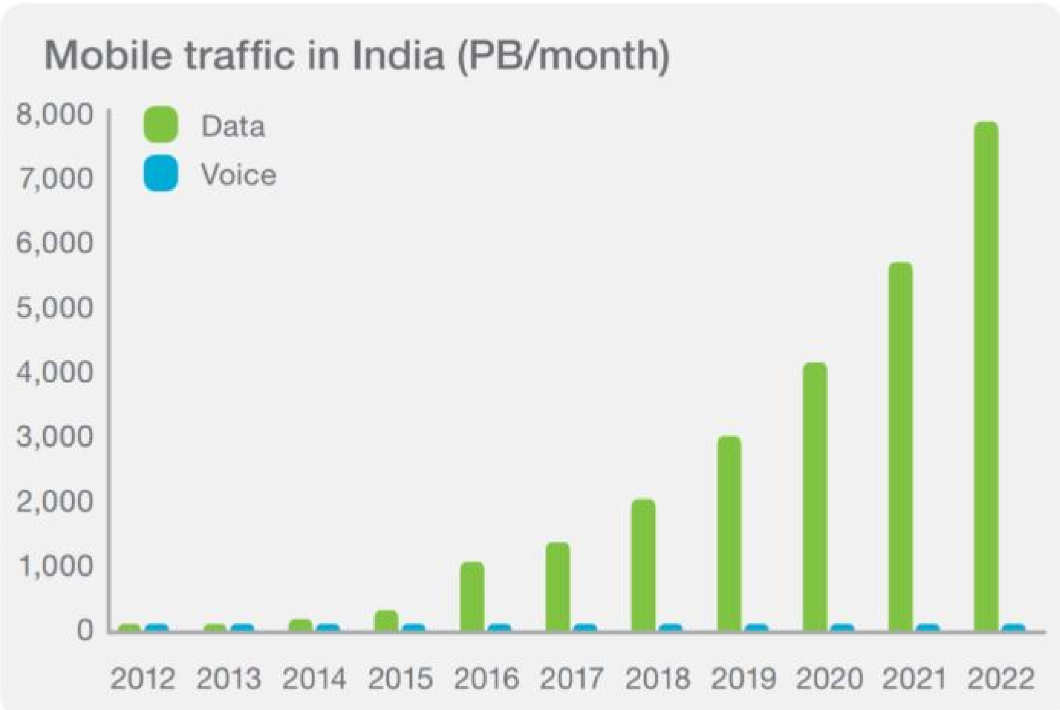
Shemaroo's content gets monetized mainly through television and digital media and for Shemaroo to grow, it is important that both the mediums grow independent of each other.

As far as traditional media i.e. television sector is concerned; it's going through a paradigm shift due to the on-going cable digitization and the benefits are expected to accrue in the coming years.

The TV segment grows through a combination of advertising and subscription. As per the estimates of KPMG, the long-term forecast for advertising growth in the television industry remains robust at 14.4% CAGR over 2016-21, due to strong economic fundamentals and India remaining a mass market consumption story. On the subscription front as well, the report estimates 14.8% CAGR over 2016-21.

As far as Digital Media is concerned, its growth is being driven by unprecedented growth in mobile data consumption in India. The tug of war between telecom providers has resulted in a massive drop in data rates. Consequently, mobile phone users are consuming a lot more data on daily basis than ever before. The availability of high-speed data connectivity is one of the primary reasons behind exploded data consumption in India.

By the end of 2016, Indian mobile users were consuming 1 exabyte of mobile data per month. However, estimates suggest data consumption will grow by nearly 40% CAGR to reach 8 exabytes of monthly usage by 2022! This represents an eight-fold increase in just six years.



Source: Dazeinfo.com

How Indian users are consuming mobile data? The importance of smartphones as a way to access the internet in India cannot be overstated. In fact, by the end of 2016, 94% of mobile data traffic came through smartphones. This number is set to rise to around 97% by 2022! Of course, this means that users' smartphone usage habits are intrinsically linked to data usage as well. In accordance with the global trend, video streaming and social media are very popular in India as well. The integration of video with social media has further lead to the boom in data usage. In fact, streaming, in general, is becoming increasingly popular. 50% of smartphone users are watching in social videos and live streams on video-centric apps at least weekly, while 25% are regularly watching videos and podcasts from music streaming apps.

Thus, with the rapid increase in data consumption, advertisers' interest is following the ongoing shift in consumption trends towards digital media. It is expected that Digital advertising will grow at a robust CAGR of almost 31% between 2016 and 2021, making this the fastest-growing segment in the M&E industry.

Promoters/Management

Shemaroo is an owner operated business with 3 brothers Buddhichand, Raman and Atul Maroo helming the affairs of the company and ably supported by Mr. Hiren Gada, the CFO of the company.

Over the years the promoters have continuously been able to transform their business. They started with circulating mags-book library, then upgraded to VHS library, in late 80s entered the business of acquiring movie titles and since then have been continuously upgrading to various distribution platforms.

While upgrading the business, the promoters have also been conservative and largely shied away from relatively riskier business of movie production and content acquisition in first cycle.

Shareholding pattern (as reported on BSE)

	Dec'17	Sep'17	Jun'17
Promoter and Promoter Group	**65.82%**	**65.82%**	**65.82%**
India	59.12%	59.12%	59.12%
Foreign	6.71%	6.71%	6.71%
Public	**34.18%**	**34.18%**	**34.18%**
Total	**2,71,82,239**	**2,71,82,239**	**2,71,82,239**

In small/mid cap companies, it's important as an investor that the promoters hold reasonably high stake and in the case of Shemaroo, promoters hold more than 65% stake which is very good in our view.

As on 31st Dec'17, the major shareholders of the company and their stakes are as below:

Name of the shareholder	Category	% stake in Shemaroo
Promoters and PAC	Promoters	65.82%
New Horizon Opportunities Master	Public	9.62%
Fidelity Funds – Asian smaller companies pool	Public	4.37%
Fidelity Asian Values Plc	Public	1.81%
Tata Investment Corporation	Public	1.47%
Kitara India Micro Cap Growth	Public	1.15%

Shemaroo Entertainment – Performance Snapshot

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Operating Profit	32.23	46.09	57.38	65.75	87.66	110.53	127.65
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Other Income							
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Finance charge	-15.33	-19.21	-18.31	-19.23	-21.21	-22.83	-32.32
Depreciation	-2.71	-2.94	-2.98	-2.96	-3.67	-3.69	-4.16
Profit Before tax (PBT)	16.22	29.04	37.44	44.29	64.04	86.11	95.92
Profit After tax (PAT)	12.99	21.02	24.68	27.84	41.81	55.43	61.68

Source: Shemaroo Entertainemnt's ARs

As far as operating performance of the company is concerned, we believe the company has performed well and if the management is able to walk the talk then all the operating metrics including debt reduction and cash flows will start looking good.

Since FY 12, Shemaroo has recorded 18.5% CAGR in sales, 22.5% CAGR in operating profit and 26% CAGR in before tax profitability. The above growth has been achieved on the back of 44% CAGR in new media sales and expansion in operating margins from 25.5% in FY 12 to 30% in FY 17.

Since the last 2 years the growth in traditional media has tapered off a bit to single digits; however as per the management the revival in ad spends has been good and it is hopeful of double digit growth rate in traditional media and around 40% in new media segment.

Important Numbers	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17
ROAE (%)	14.82%	19.23%	17.75%	16.96%	16.77%	15.99%	15.31%
Cash Flows from operations	7.57	-3.06	-18.45	-36.03	-49.42	-63.12	-87.62
Inventory	53.13	96.92	146.46	198.01	287.88	383.75	497.32
Sales to Inventory ratio	2.92	1.86	1.46	1.33	1.12	0.98	0.83
Net Debt	101.8	103.37	121.15	182.44	134.61	211.31	294.98
Debt to Equity ratio	1.18	0.86	0.81	1.03	0.43	0.57	0.68

Source: Shemaroo Entertainment's ARs

In case of Shemaroo, the cause of concern for the investors has been negative operating cash flows for all the last 5 years. We believe it is important to understand here that Shemaroo classifies all its content as inventory (even the perpetual rights) even though the content gets monetized over a period of 5 years in aggregate rights and 10 years and beyond in case of perpetual rights. So, certain investment in inventory is of the nature of CAPEX; however as it is classified as inventory the cash outflow is put under operating cash flows.

Contrary to Shemaroo's practice, EROS classifies most of its movie rights as intangible assets which it amortizes in P/L account and writes back in Cash flow account; however in our view Shemaroo's accounting policy is more conservative and transparent.

Secondly, even at the time of IPO, management had clearly indicated that they will do an aggressive investment to build up the library and therefore currently monetization is lagging behind and there's cash flow mismatch.

As per the management, they have now reached a phase where aggressive investment is not needed and going forward inventory should stabilize and there should also be debt reduction.

So, as mentioned above, if the management is able to walk the talk the operating performance of Shemaroo will start looking good on all the metrics including balance sheet and cash flow generation.

Valuations

From the above discussion we know that video data consumption has been growing exponentially and sooner than later advertisers will follow the consumption pattern and increase spending on digital media.

We also know that Shemaroo has the content to offer both on traditional media and new media and gain from both increase in volume (data consumption) and realizations (higher subscription and advertisement rates).

For the last 5 years the company has averaged 18-20% growth rate in sales. Barring the recent slowdown, we believe the growth rates are again likely to go back to 18-20% on the back of revival in ad spends in both the mediums. As far as profitability is concerned, the growth is likely to be much higher on account of twin factors of margin expansion (higher contribution from new media) and debt reduction.

Thus, looking at decent growth prospects and long run-way ahead, we believe the valuations are reasonable at around 21 times trailing twelve months earnings.

Risks & Concerns

While the data consumption is growing in big way; the realizations from the same may not necessarily follow the same trajectory and growth projections may falter.

Digital media space is evolving very fast; Shemaroo may not necessarily be able to upgrade its business and therefore miss out on business opportunities.

Content is feedstock for Shemaroo's business; competition from known/unknown sources can drive the cost of content to unrealistic levels and impact Shemaroo's profitability and stated objective of minimum 18% ROI.

Disclosure: I don't have any investment in Shemaroo Entertainment and have not traded in the stock in the last 30 days.

Best Regards,

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Rating Interpretation

Positive – Expected return of ~15% + on annualized basis in medium to long term for investment recommendations and in short term for Special situations
Neutral – Expected Absolute return in the range of +/- 15%
Negative – Expected Absolute return of over -15%
Coverage closure – No further update on the stock
% weightage – allocation in the subject stock with respect to equity investments

Short term – Less than 1 year
Medium term – Greater than 1 year and less than 3 years
Long term – Greater than 3 years

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Analyst ownership of the stock: No

Details of Associates: Not Applicable

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