Shemaroo Entertainment

(SHEM IN, BUY, CMP: Rs515, PT: Rs635)

First class pickings in the second stage of movie lifecycle

analysis adds up

February 15, 2018

Table of content

First class pickings in the second stage of movie lifecycle

SHEM IN, CMP: Rs515 — BUY, PT: Rs635

Shemaroo (SHEM IN) is one of the largest independent content aggregators with a library of more than 3,500 titles. It positions itself in the 2nd stage of movie lifecycle, where content risk is lower, while aiming for a portfolio IRR of ~18%. We expect a top line CAGR of 17.1% over FY17-FY20E to Rs6.83 bn. With favorable inventory cycle and no further build ups in inventory expected, we expect EBITDA margin of 32% in FY19E and FY20E, net debt to equity ratio falling from 0.52x currently to 0.20x by FY20E. We value SHEM at 2.75x FY20E EV/Sales, corresponding to the stock's average P/E valuation of 12.7x FY20E earnings, arriving at a target price of Rs635. We thus recommend BUY Shemaroo

Expect 16.6%/16.1% growth in FY19E/FY20E: Going forward, we expect NM (New Media) to grow at 35%/30% y-y and TM (Traditional Media) to grow at 10%/10% y-y in FY19E/FY20E. TM growth driver is TV industry revenue, which is expected to grow at a CAGR of 14.65% over FY16-FY21E. NM growth drivers include internationalization, rising ARPU, increased data consumption and other growing platforms such as Hotstar and YouTube

Expect EBITDA margin of 32%/32% in FY19E/FY20E: Until FY17, EBITDA margin was dominated by inventory build up. But going forward, visibility is that lower direct costs, rather than inventory, will contribute heavily to margin. We build in gross profit margin of 44% (Around current levels) until Q4 FY20E, leading to an EBITDA margin of 32.0% in FY19E and FY20E

CFFO turning +ve, debt reduction: We expect cumulative cash flow from operations (CFFO) of Rs2.87 bn over FY18E-FY20E, vs. cumulative outflow of Rs1.38 bn over FY15-FY17. We thus expect gross debt to reduce from Rs2.47 bn in Sep-17 to Rs1.51 bn in Mar-20E, reducing net debt to equity ratio from 0.52x in Sep-17 to 0.20x by Mar-20E

Valuation: We initiate coverage, recommending BUY on SHEM with a PT of Rs635 based on 2.75x FY20E EV/Sales, which is one standard deviation above SHEM's historic average valuation of 2.4x

Risks: Content library, operating results variability, competition, customer concentration, technology risks in NM, legal risks

Financials and valuation

YE March	Revenue (Rs mn)	Revenue Growth (%)	EBITDA (Rs mn)	EBITDA Margin (%)	PAT (Rs mn)	PAT Growth (%)	EPS (Rs)	EV/Sales (x)	P/E (x)	Net D/E (x)	ROCE (%)
FY16	3,751	16.0	1,078	28.8	523	27.8	19.2	4.2	26.8	0.53	20.9
FY17	4,255	13.5	1,275	30.0	613	17.2	22.6	4.0	22.8	0.69	19.0
FY18E	5,044	18.5	1,362	27.0	684	11.5	25.1	3.4	20.5	0.60	17.3
FY19E	5,883	16.6	1,883	32.0	1,092	59.7	40.1	2.8	12.8	0.40	22.4
FY20E	6,833	16.1	2,187	32.0	1,358	24.4	49.9	2.3	10.3	0.20	24.7

Source: Company, quant Global Research estimates

Market data

Market cap:	Rs14.0 bn (US$218 mn)
52-week high/low:	Rs595/317
Share o/s (Fully diluted):	27.2 mn
Next dividend payment on:	NA
Avg daily trading vol (3m):	56.1 ('000)
Avg daily trading val (3m):	Rs27.5 mn (US$0.43 mn)

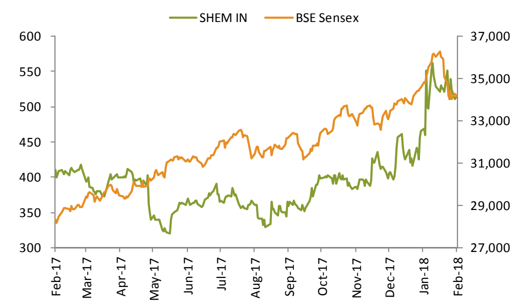
Source: BSE, Bloomberg

Shareholding pattern (%)

	Dec17	Sep17	Jun17
Promoters	65.8	65.8	65.8
Public	34.2	34.2	34.2
Others	0.0	0.0	0.0
Total	100.0	100.0	100.0

Source: BSE

Price movement (Rs) vs the Sensex



Source: BSE

Shemaroo has 900+ perpetual titles in a 3,500+ strong library

Co plays in the 2nd stage of the movie lifecycle, which lowers content risk

Shemaroo, the leading independent content aggregator

- Shemaroo is one of the largest independent content aggregators with a library of **more than 3,500 titles**, consisting of over 900 perpetual titles, which are distributed across various existing and emerging media platforms
- Shemaroo has pioneered the movie library syndication business by acquiring movie titles from producers and distributing them to media platforms for 5 years (Satellite based broadcasters) or 2-3 years (Digital media platforms)
- The Company has grown by creating this library and harvesting existing relationships across the media industry value chain to become one of the largest players in a fragmented industry

Shemaroo's strategic positioning in 2nd stage of movie lifecycle lowers the risk element

- Shemaroo typically participates in the second and subsequent cycles of film monetization, which have been growing due to factors such as increasing advertisement spends, deepening subscription, digitization leading to consumption via mobile applications, and the rapid proliferation of the 4G network
- Shemaroo decides on the cost of the content after it is confident of achieving the **desired RoI (Approx. 18% IRR) at the portfolio level**
- **Risk is lower** in these cycles due to visibility of performance of movie during first cycle of launch

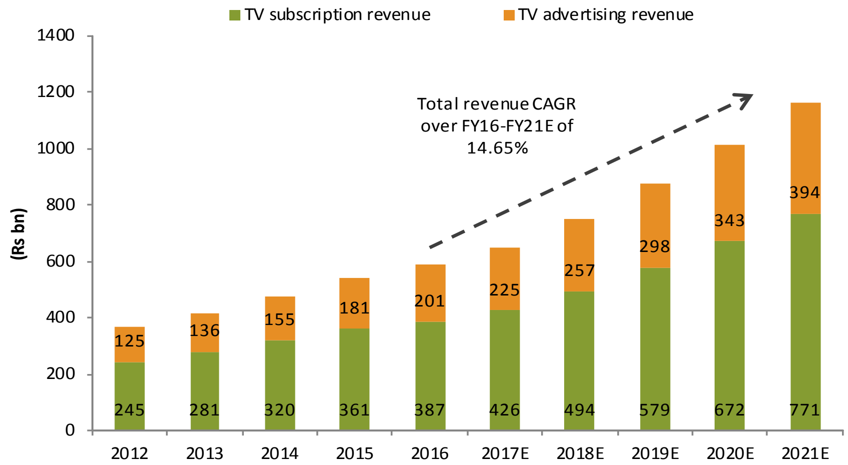
Experienced leadership behind the successful business model

- Shemaroo was founded in 1962 by Chairman Mr Buddhichand Maroo. Managing Director Mr Raman Maroo, with 34 years' experience in the media & entertainment industry, is the driving force of Shemaroo, and Joint MD Mr Atul Maru (37 years' experience) runs operations and spearheads initiatives such as the home video division
- Mr Jai Maroo (14 years' industry experience) leads the new media business. CFO Mr Hiren Gada (14 years' industry experience) handles the strategy and finance aspects of the Company
- The Company has further strengthened its management by adding four middle and senior management level executives recently in the areas of marketing, innovation and relationships in the traditional media segment

Media & Entertainment industry has robust prospects

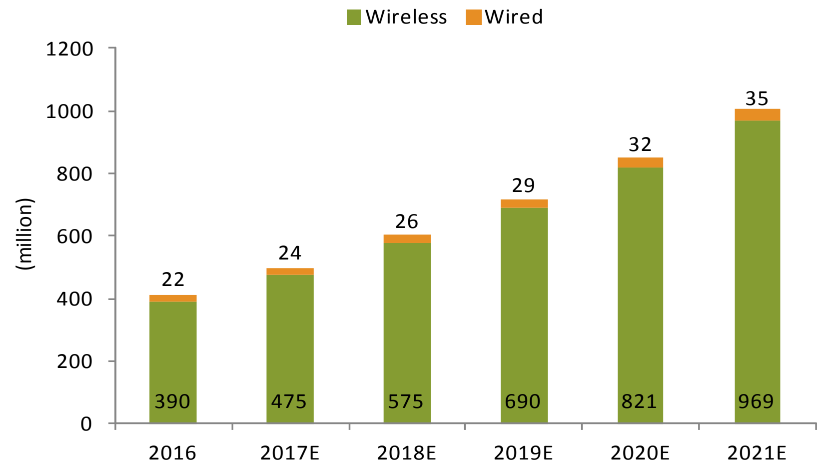
Traditional Media (TM) is growing in mid-teens; hyper growth in New Media (NM)

TV industry revenue to grow at a CAGR of 14.65% over FY16-FY21E



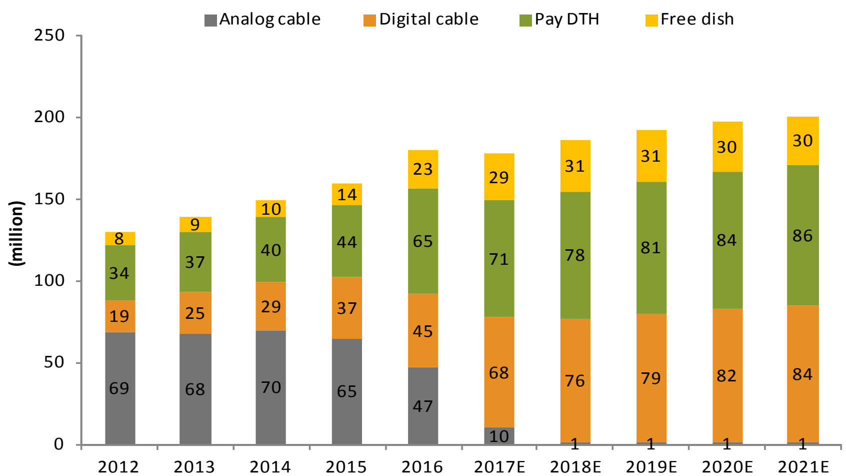
Source: KPMG FICCI India Media and Entertainment Industry report 2017, quant Global Research

Number of wireless internet users in India is expected to grow 150% over 2016-2021E



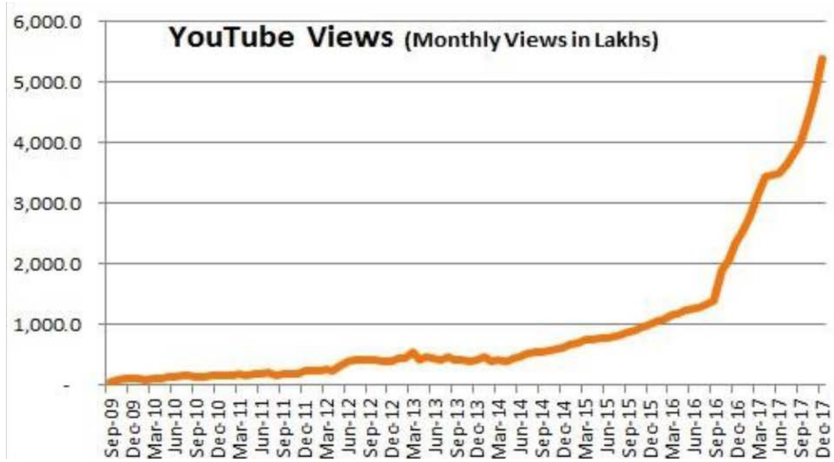
Source: KPMG FICCI India Media and Entertainment Industry report 2017, quant Global Research

Digital cable and Pay DTH is expected to grow 50% over 2016-2021E



Source: KPMG FICCI India Media and Entertainment Industry report 2017, quant Global Research

Number of views on YouTube, with just under 30% of NM revenue, is growing exponentially



Source: Company, quant Global Research

Shemaroo's operating segments

Long standing relationships in TM; 3 sub-segments within NM, MVAS being the largest

Shemaroo's television syndication (TM)

Partners	USP	Drivers
• Star Gold, Viacom 18, Sony Max, Zee Cinema, UTV Movies, among others	• Tie ups with producers such as RK Films, Tips, Viacom 18, Red Chillies, among others	• Indian TV industry growing at a CAGR of 14.7% over 2016-2021E to Rs1.17 tn • Phase-IV digitization completed in Mar-17, DTH players launching Rs99 (Add On) entry level packs
• Subscription based ad free content services across genres like movies, devotion, comedy and regional	• Content library has 948 perpetual rights, including 443 in Hindi	• Movies as a genre is second in terms of viewership after General Entertainment Channels
• Distribution of rights to other media platforms like in flight entertainment, international film festivals, etc.	• Overall content library has over 3,500 titles, spanning recent films, blockbusters, evergreen movies and special content	• Success of 1) FTA channels, which The FTA channels garnered an estimated Rs4-5 bn of the overall TV advertising pie in 2016, and is expected to rise to Rs8-10 bn in 2017, and 2) DD FreeDish, which acquired 22 million customers by end of 2016

Sheamroo's Digital Media (NM)

Partners	USP	Drivers
• YouTube - ads based - 40+ channels - 350mn+ views per month - 52.5% revenue share from YouTube	• Large library, variety of content, including songs and regional content	• DM spending to grow at 30.8% CAGR over 2016-2021E
• Hotstar, Reliance Jio, Netflix, etc. - subscription based	• Ability to tailor the length and format of content as per requirement - a 200 member strong team works on content repurposing and refurbishing	• Growth in internet users (254.4 mn in Sep-14 to 429.2 mn in Sep-17), broadband users (75.7 mn in Sep-14 to 324.9 mn in Sep-17), online video audience (Share in mobile traffic to rise from 49% in 2016 to 75% in 2021E)
• MVAS agreements with major telcos such as Airtel, Vodafone, Idea		• 4G expansion feeding into YouTube growth, YouTube ads ecosystem

Source: FICCI-KPMG, DD FreeDish, Company, quant Global Research

Shemaroo's content library

Focus on aggregating sizeable quality content the key behind successful monetization

Complete ownership rights | **In-house creation** | **Limited ownership rights**

Perpetual rights - Complete ownership rights for distribution across all geographies, platforms, and perpetual periods

Aggregate rights - Rights limited by either period of usage, platforms, geography or a combination thereof

Content library

- Hindi films
- Regional
- Devotional
- Kids
- Comedy
- Music
- Special interest content
- Other content

Monetisation platforms

Digital Media

- Mobile
- Internet
- OTT
- Other Platforms

Traditional Media

Television Syndication

- Satellite
- Terrestrial
- Cable
- DTH

Home Video

- VCD
- DVD
- Blu-Ray

Others

- Overseas
- In-flight, etc.

Content library as on April 30th, 2017

Type of content	Perpetual titles	Aggregated titles	Total number of titles
Hindi films	443	1423	1866
Regional titles	456	984	1440
Special interest content	49	230	279
Total	**948**	**2637**	**3585**

Source: Company, quant Global Research

- Content cost has been consistently rising as growth in TM+NM industry has outpaced growth in quality content production
- Shemaroo uses proprietary tools and considers various other factors for content valuation such as cast, production house, awards, genres, viewership, box office records and online reviews

Shemaroo financial performance & expectations

Co profitability well-managed, though headroom for balance sheet improvement

Growth drivers are ad & subscription growth in TM, and digitization and propagation of data in NM

- Going forward, we expect NM (New Media) to grow at 35%/30% and TM (Traditional Media) to grow at 10%/10% y-y in FY19E/FY20E. TM growth ~10% y-y is expected to continue given industry ad & subscription growth rate of 14-15%. NM's current growth profile of ~40% y-y is expect to retard a tad given 1) the high base and 2) YouTube's incrementally stringent monetization and partnership requirements.
- Other than YouTube, key segments within NM are 1) telco wallet ecosystem – MVAS (Over 50% of NM), growth driver has been internationalization, rising ARPU and increased data consumption, and 2) syndication based – Jio, Netflix, Hotstar among others (~20% of NM)
- We thus expect 10.7%, 35.6% CAGR in TM, NM, respectively, culminating in top line CAGR of 17.1% over FY17-FY20E

Profitability to remain strong given increasing NM, favorable inventory cycle and reducing debt

- Until FY17, EBITDA margin was dominated by inventory build up. But going forward, visibility is that lower direct costs, rather than inventory, will contribute heavily to margin
- We build in gross profit margin of 44% (Around current levels) from Q4 FY18 to Q4 FY20E, which, we believe, has further upside because of 1) large amount of historically hosted content on NM and 2) copyrights purchased prior to 2013 will enter second block of 5 years, which will have lower amortization
- Due to reducing debt, we also expect finance charges to decline from ~Rs70 mn per quarter to a run rate of ~Rs50 mn per quarter by FY20E. We thus expect PAT to grow at a CAGR of 30.4% from FY17 to Rs1.36 bn in FY20E

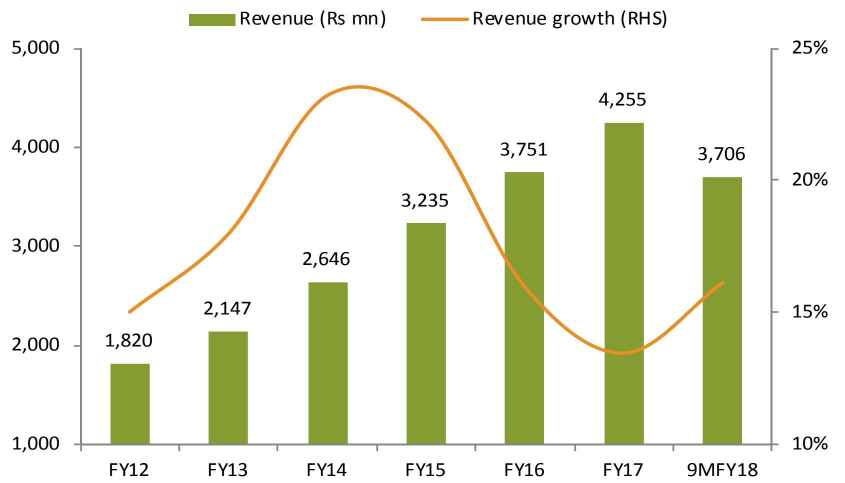
Balance sheet getting stronger and cash flow from operations turning positive this financial year

- Given no further build up in inventory in FY19E and FY20E, we expect cumulative cash flow from operations of Rs2.87 bn over FY18E-FY20E, vs. cumulative outflow of Rs1.38 bn over FY15-FY17
- We thus expect gross debt to reduce from Rs2.47 bn in Sep-17 to Rs1.51 bn in Mar-20E, reducing net debt to equity ratio from 0.52x in Sep-17 to 0.20x in Mar-20E
- Although debtor days are expected to remain elevated at ~150-160 days, we expect inventory turnover to improve from 1.0x

Shemaroo expected to grow at 17.1% CAGR over FY17-FY21E

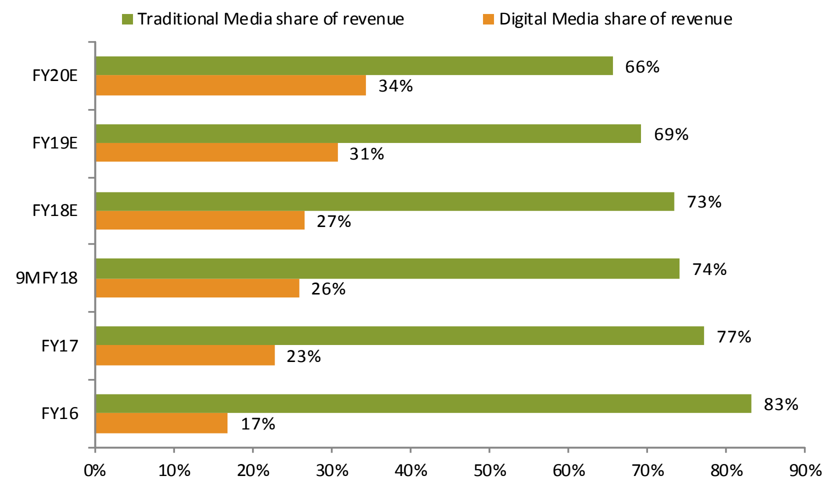
Growth driven by 10.7%, 35.6% CAGR in TM, NM over FY17-FY20E

Given the strong track record, we expect a CAGR of 17.1% over FY17-FY21E



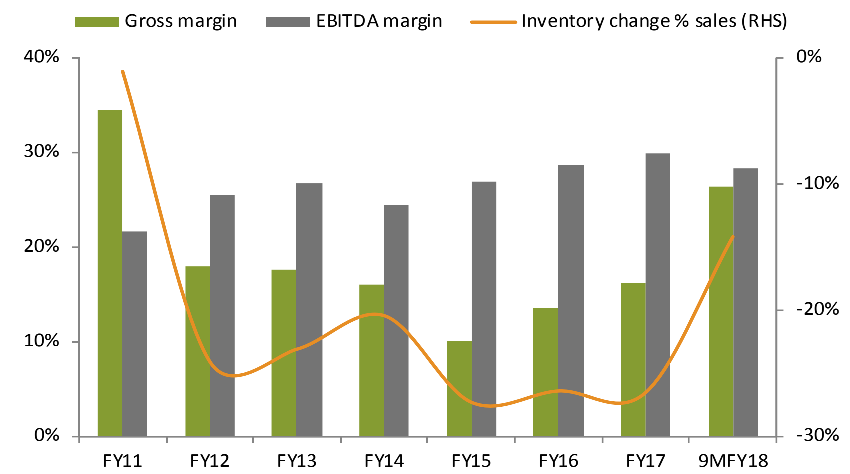
Source: Company, quant Global Research

We expect 10.7%, 35.6% CAGR in TM, NM, respectively, over FY17-FY20E



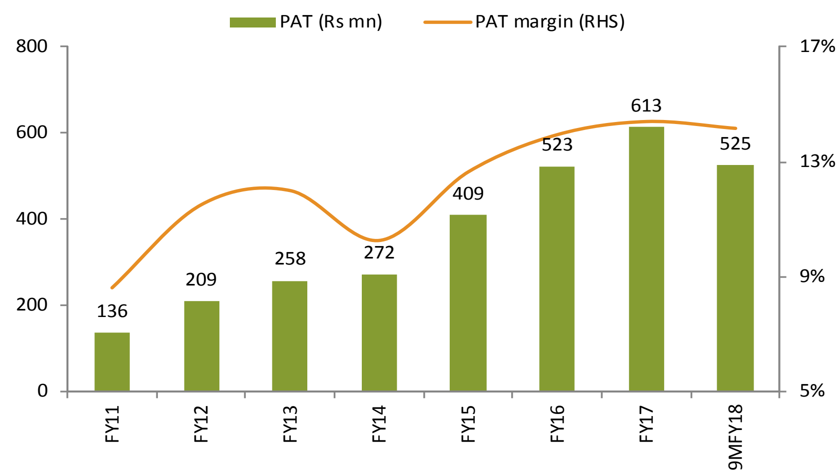
Source: Company, quant Global Research estimates

Going forward, inventory additions to play a muted role as gross margins improve



Note: 9M FY18 growth is annualized. **Source**: Company, quant Global Research

We expect PAT to grow at a CAGR of 30.4% from FY17 to Rs1.36 bn in FY20E

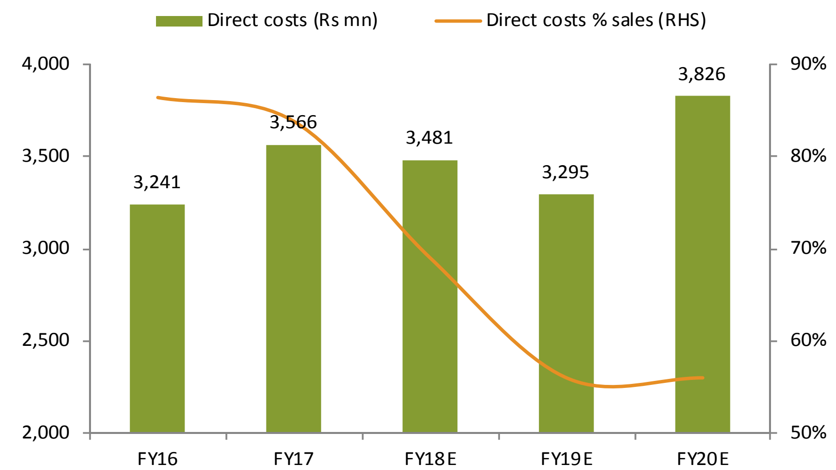


Source: Company, quant Global Research

Forecast reduction in net debt to equity to 0.2x by FY20E

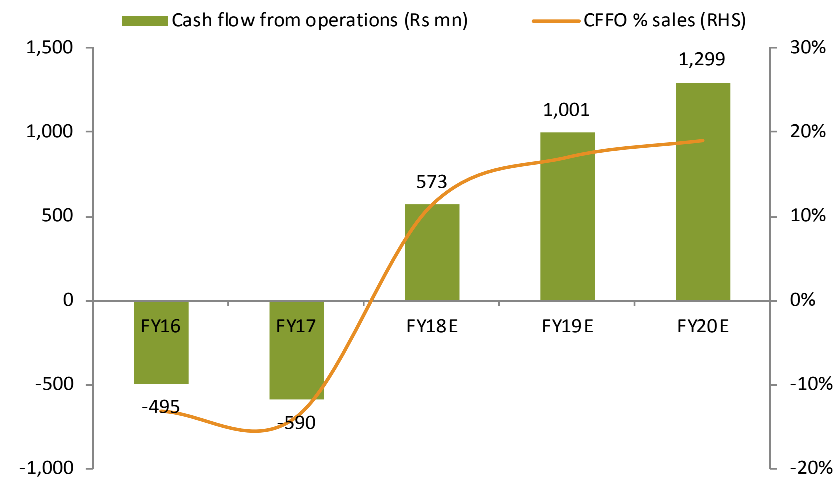
We estimate an inflow of cash flow from operations of Rs2.87 bn over FY18E-FY20E

Driven by favorable inventory lifecycle, expect direct costs to provide economy



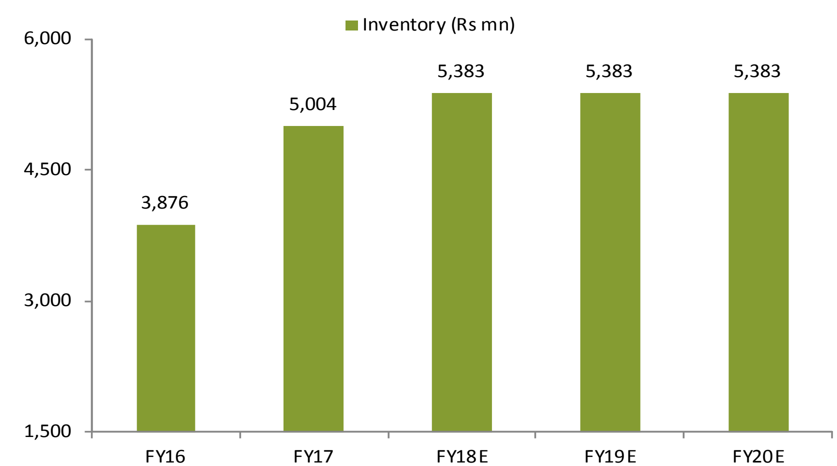
Source: Company, quant Global Research estimates

Muted inventory additions will aid CFFO into positive territory in FY18E-FY20E



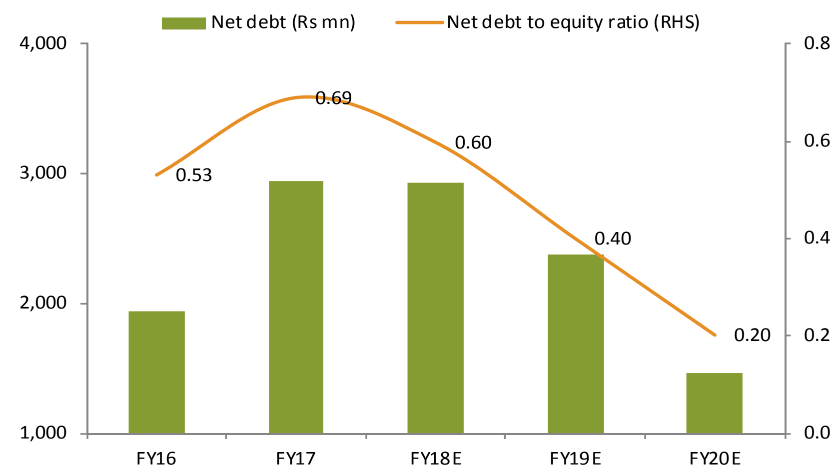
Source: Company, quant Global Research estimates

Management has guided firmly for muted inventory additions in FY19E, FY20E



Source: Company, quant Global Research estimates

We expect net debt to equity to reduce to 0.20x by FY20E



Source: Company, quant Global Research estimates

Valuation

quant
analysis adds up

February 15, 2018

A closer look at Shemaroo's content-related accounting policies

Co follows inventory classification, à la Zee; Eros applies intangible asset classification

Shemaroo has been accumulating content in inventory, which has been aiding operating margin, while cash flow generation has been –ve

- Copyright is valued at a certain percentage of cost based on the nature of rights. The realizable value and/ or the revenue potential of inventory is evaluated based on management estimates of market conditions and demand. Appropriate write down is made when warranted
- SHEM inventory as on Dec-17 was Rs5.53 bn. Based on Sep-17 balance sheet, inventory constituted 71.6% of total assets and change in inventory aided operating margin to the extent of 14.2% of sales in 9M FY18. Inventory turnover ratio in 9M FY18 was 0.88x vs. 1.0x in FY17
- SHEM has been consistently negative in cash flow generation, recording cash flow from operation (CFFO) of -Rs299, -Rs495 and -Rs590 mn in FY15, FY16 and FY17, respectively. Meanwhile, its EBITDA margin has been 26.9%, 28.8% and 30.0%, respectively

For valuation purposes, we thus prefer EV/Sales over P/E

- Market analysts popularly use P/E to value SHEM. However, because of the play of inventory and its polarizing impact on margins vs. negative cash flow generation, we believe that a more holistic parameter is needed as primary methodology
- **EV/Sales is our preferred methodology as it captures the market opportunity within the value created irrespective of leverage.** Concurrently, we keep a close eye on inventory turnover and leverage ratios
- However, we will use P/E as a secondary methodology in order to facilitate 1) Comparison to market multiple, and 2) also because **in times of stable additions to inventory, Shemaroo's earnings may not be significantly different from accrual-based earnings** (Refer p. 14)

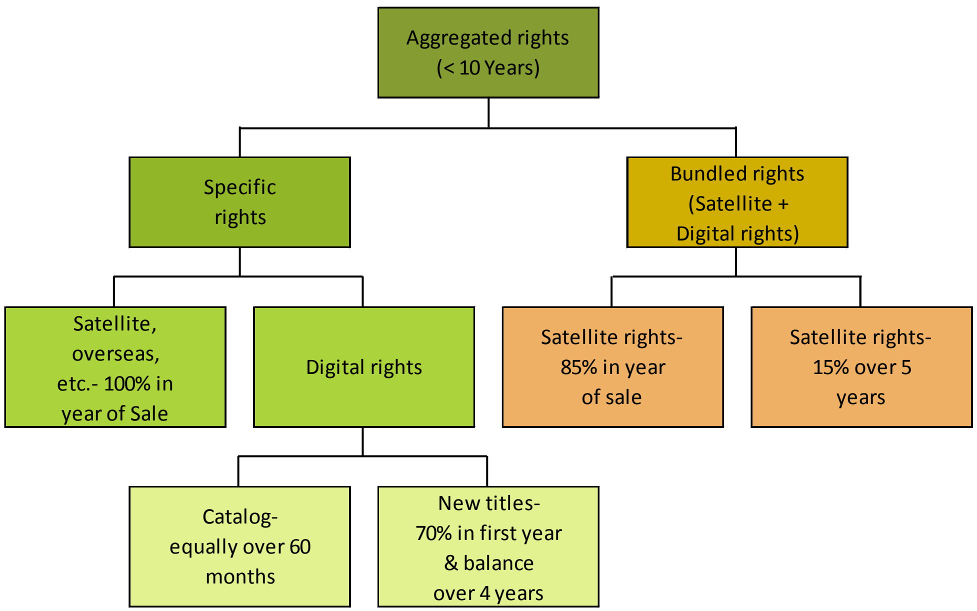
Shemaroo's inventory classification is followed by Zee Entertainment, Balaji Telefilms

- Across Companies, in inventory classification, the media content is stated at lower of cost/ unamortized cost or realizable value
- **Zee Entertainment:** uses inventory based accounting, film rights amortized on straight-line basis, satellite rights expensed immediately
- **Balaji Telefilms:** uses inventory based accounting, cost of films is expensed in the ratio of current revenue to expected total revenue, FY17 content turnover was 1.2x
- **Eros:** Investments in films and associated rights stated as intangible assets at cost less amortization less provision for impairment. Second cycle content or 'Library' is amortized evenly over the lesser of 10 years or license period. FY17 content turnover was 0.5x

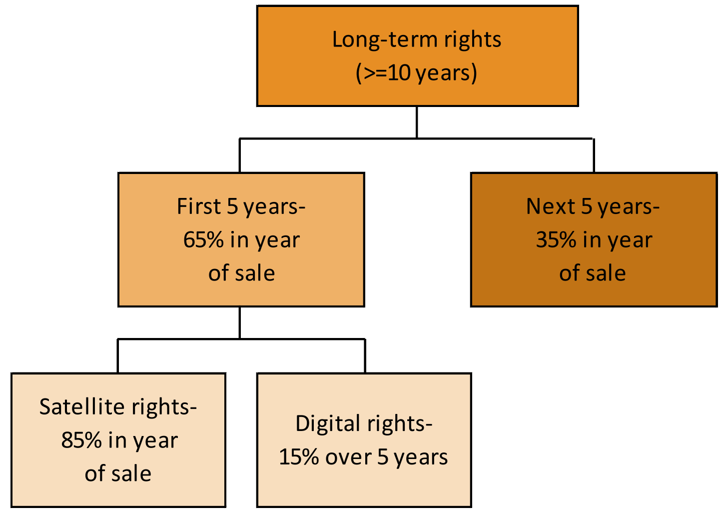
Shemaroo’s accounting policies

Perpetual rights (60 years) are amortized away fully in first 10 years

Amortization policy for aggregated rights



Amortization policy for perpetual rights



Source: Company

- On the following slide, we have displayed the results of a theoretical exercise of trying to compare Shemaroo’s inventory based accounting with accrual based accounting
- We assume D:E of 34:64, same as Shemaroo’s H1 FY18 financials. We assume no content-holding period, in contrast to actual of approx. 180 days in TM and ~90 days in NM. We assuming cost of debt of 13%
- In the case of accrual based accounting, it is the non-current assets that are being built up, and then amortized on an accelerated basis. In accrual based accounting, we use accelerated amortization of 60% in first year, followed by equal depreciation in ensuing years until year 5, by when the content is fully amortized
- Revenue is marked up to provide for an equity IRR of 18%, employee and SG&A expenses are assumed at 18% of sales

Shemaroo’s accounting compared to accrual-based accounting

A theoretical exercise reveals SHEM’s earnings would outpace accrual-based earnings

- This is a purely **theoretical exercise** of comparing the impact of difference between inventory-based accounting and accrual-based accounting in hypothetical scenarios with several assumptions. **We are not, in any way, alleging that Shemaroo is using improper or unsuitable accounting practices:** as mentioned on p. 12, the inventory based accounting methodology is commonly followed in the industry
- Since listing, SHEM has been in accelerated content purchase mode, which will turn to consistent purchases over FY19E and FY20E

CASE 1: Consistent content purchase	Y0	Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10
Inventory addition	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**0**
Sales	0.0	83.1	92.3	102	111	120	130	130	130	130	130

Starting with Rs100 in Y0, content is accumulated in a consistent pace through ten years, leading to total purchase of Rs1,000. In the case of accrual based accounting, it is the non-current assets that are being built up, and then depreciated on an accelerated basis. For both SHEM and accrual based accounting, starting with a debt to equity ratio of 0.52x, we are left with a debt to equity ratio of 0.15x at the end of year 10, but SHEM reaches 0.15x a year earlier, i.e. in Y9

	Y0	Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10
Shemaroo PAT	0.0	21.3	15.6	10.4	5.7	1.3	(3.0)	(3.3)	(3.4)	(3.5)	(73.5)
Accrual PAT	0.0	3.1	(0.4)	(3.5)	(6.2)	(8.5)	(3.0)	(3.3)	(3.4)	(3.5)	(3.5)
Difference % sales		**22%**	**17.4%**	**13.8%**	**10.7%**	**8.2%**	**0.0%**	**0.0%**	**0.0%**	**0.0%**	**-53.9%**

CASE 2: Accelerated content purchase	Y0	Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10
Inventory addition	**100**	**200**	**300**	**400**	**500**	**600**	**700**	**800**	**900**	**1000**	**0**
Sales	0.0	83.1	175	277	388	508	638	767	897	1027	1157

Starting with Rs100 in Y0, content is built at an accelerated pace through ten years, leading to total content purchase of Rs5,500. Starting with a debt to equity ratio of 0.52x for both SHEM and P&L Acc., at the end of year 10, we are left with a debt to equity ratio of 0.17x for accrual-based accounts and 0.15x Shemaroo's accounts

	Y0	Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10
Shemaroo PAT	0.0	91.3	107	117	123	124	121	118	115	111	(662)
Accrual PAT	0.0	3.1	2.7	(0.8)	(7.1)	(15.6)	(18.6)	(21.9)	(25.3)	(28.8)	(32.3)
Difference % sales		**106%**	**59%**	**42.7%**	**33.5%**	**27.6%**	**21.9%**	**18.2%**	**15.6%**	**13.6%**	**-54.5%**

CASE 3: Decelerated content purchase	Y0	Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10
Inventory addition	1000	900	800	700	600	500	400	300	200	100	0
Sales	0	831	840	840	830	811	791	661	531	402	272

Starting with Rs1,000 in Y0, content is built at a decelerated pace through ten years, leading to total content purchase of Rs5,500. Starting with a debt to equity ratio of 0.52x, at the end of year 10, we are left with a debt to equity ratio of 0.06x for accrual-based and 0.07x Shemaroo's accounts

	Y0	Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8	Y9	Y10
Shemaroo PAT	0.0	143	65.1	(2.7)	(60.8)	(109.8)	(154.8)	(153.9)	(152.2)	(149.7)	(146.5)
Accrual PAT	0.0	31.3	(7.4)	(38.2)	(61.5)	(77.8)	(14.9)	(14.0)	(12.3)	(9.8)	(6.6)
Difference % sales		**13.4%**	**8.6%**	**4.2%**	**0.1%**	**-4.0%**	**-17.7%**	**-21.1%**	**-26.3%**	**-34.8%**	**-51.5%**

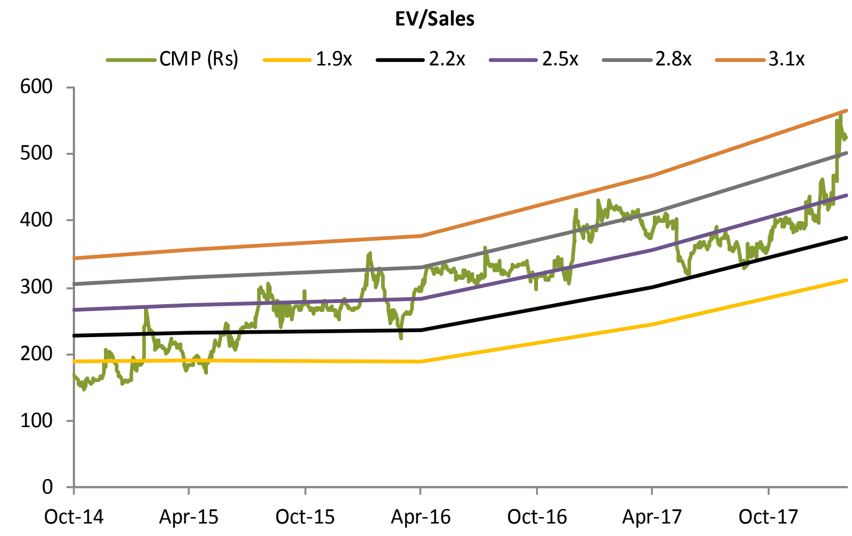
Source: Company, quant Global Research estimates

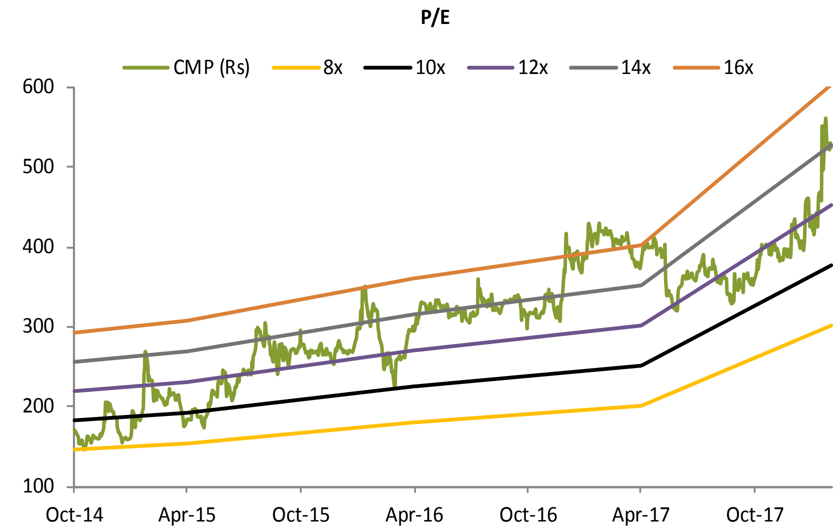
SHEM profits in mature half of content cycle concurs with profits of accrual based accounts

Since listing, SHEM has been reporting steady profit margins. Our theoretical exercise, though heavily punctuated with assumptions, leads us to believe that **SHEM’s P&L profit margins may not provide the fullest picture of the firm’s financials**

Valuation & recommendation: BUY

We value SHEM at 2.75x FY20E EV/Sales, yielding a PT of Rs635





Source: BSE, Company, quant Global Research estimates

ACCUMULATE: PT of Rs635 corresponds to 2.75x FY20E EV/Sales, which is fair valuation for a Company with a moat of a large library and thriving ecosystem

- Our preferred methodology to value SHEM is EV/Sales. Sales values market opportunity. Enterprise value adjusts for debt or equity as invested capital
- The next preferred valuation methodology is P/E, commonly used by the market, but secondary for us, given the vagaries of SHEM's earnings
- We value SHEM at **2.75x EV/Sales of FY20E, which is one std. deviation above the stock's average historical valuation since listing**
- We believe SHEM's growth in TM will continue (10.7% CAGR over FY17-FY20E), driven by strong traction in industry ad & subscription. NM growth may reduce on high base, but strong growth (35.6% CAGR over FY17-FY20E) will likely continue
- Profitability is expected to improve with lower direct costs (on the back of no material increase in inventory for next ~2 yrs). We expect EBITDA margin of 32%/32% in FY19E/FY20E
- Avg. valuation of 2.4x EV/Sales is surpassed given (1) favorable inventory cycle, reducing direct costs, (2) lower investment into inventory, leading to improvement in debt to equity ratio, and (3) upside from SHEM's initiatives such as miniplex and innovation with devotional songs
- Additional support for the target valuations of Rs635 is that this price corresponds to the **P/E multiple of 12.7x, which is the average P/E for SHEM** since its listing in Oct-14

Shemaroo peer valuation

Despite small size, SHEM has low P/E valuation; favorably placed w.r.t. ROE, margin

Company	Ticker	Mkt Cap (US$ mn)	CMP (Rs)	Revenue (Rs mn)		EBITDA margin (%)		PE (x)		EV/Sales (x)		ROE (%)	
				FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Balaji Telefilms	BLJT IN equity	231	146	3,791	4,151	10.2	11.2	34.0	30.5	2.5	2.3	5.9	4.9
Netflix Inc	NFLX US equity	115,207	265	15,809	19,342	12.2	15.4	87.3	55.0	7.5	6.2	25.8	28.0
Saregama	SARE IN equity	207	762	3,575	4,335	13.3	16.7	50.3	33.6	3.7	3.0	8.2	11.0
Shemaroo Entertainment	SHEM IN equity	218	513	4,874	5,673	29.5	30.0	19.5	15.6	3.4	2.9	15.6	16.7
UFO Moviez	UFOM IN equity	195	440	6,075	6,467	29.0	29.8	19.7	16.2	1.9	1.8	10.9	12.6
Zee Entertainment	Z IN equity	8,641	577	66,733	77,105	31.8	32.9	40.3	32.1	8.1	7.0	18.6	20.1

Source: Bloomberg consensus estimates; For Netflix, financials are in US$ and year end is in December

Risks to recommendation

Key risks relate to content library, operating results, competition, customer concentration, technology risks in NM and legal

- **Failure to source quality content could adversely affect content library:** SHEM earns revenues by exploiting content that is distributed through various distribution channels. Acquisition of content is an integral part of business. The ability to to maintain existing relationships and form new ones with industry participants depends upon acquiring high quality content
- **Risk to operating results:** Estimates and assumptions of cost recovery may prove to be wrong. Also, operating results may be materially and adversely affected by seasonality of business. Results may also be affected by competing leisure and entertainment activities such as cricket
- **Intensified competition may result in content cost escalation** which may restrict ability to access content at favorable terms. Any escalation in the content acquisition cost as a result of such competition could result in SHEM losing out on opportunities to acquire content, or, could impact the profitability of the content so acquired
- **Concentration risks:** SHEM is subject to customer concentration risks in the TV broadcast and new media industry. Any significant adverse changes in a group's buying patterns may have a material impact on results
- **Legal claims on acquired content:** SHEM's content library is an essential part of content acquisition strategy. As part of this due diligence process, SHEM gives public notices in film trade magazines, which provide a detailed description of the content that is to be acquired and invites claims from third parties with sufficient documentary proof. Despite this process, SHEM may receive legal claims or law suites over the acquired content
- **Technological advances:** SHEM has to remain competitive with respect to rapid technological changes, which could entail alternative methods of product delivery, storage or changes in consumer behavior, which could have a negative effect on the home entertainment market and new digital market in India
- **Legal proceedings against the Company:** As of Mar-17, SHEM is subject to disputed direct and indirect tax demands worth Rs30.3 mn and Rs13.6 mn from other legal cases

Consolidated financial statements

Y/E March

Income statement (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Revenue	**3,751**	**4,255**	**5,044**	**5,883**	**6,833**
Growth (%)	16.0	13.5	18.5	16.6	16.1
Digital Media	635	924	1,312	1,771	2,303
Traditional Media	3,121	3,244	3,633	3,997	4,396
Expenditure	**2,672**	**2,980**	**3,682**	**4,001**	**4,646**
Direct costs	3,241	3,566	3,481	3,295	3,826
Change in inventory	(990)	(1,128)	(378)	(0)	(0)
Other expenditure	421	542	580	706	820
EBITDA	**1,078**	**1,275**	**1,362**	**1,883**	**2,187**
Depreciation and amortization expense	37	43	50	57	65
EBIT	1,041	1,232	1,312	1,826	2,122
Other income	16	30	15	18	22
Interest including finance charges	228	324	310	280	200
Adjusted pre-tax profit	829	937	1,017	1,564	1,944
Less: taxes	307	342	330	469	583
PAT	522	595	687	1,095	1,361
Less: minority/ associate earnings	1	18	(3)	(3)	(3)
Net profit for shareholders	**523**	**613**	**684**	**1,092**	**1,358**
EPS (Rs), based on fully diluted shares	**19.2**	**22.6**	**25.1**	**40.1**	**49.9**
Year-end shares outstanding (mn)	27.2	27.2	27.2	27.2	27.2

Balance sheet (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Equity capital	272	272	272	272	272
Reserves and surplus	3,377	3,995	4,630	5,670	6,977
Total equity	**3,649**	**4,266**	**4,901**	**5,942**	**7,249**
Minority interest	(8)	(32)	(35)	(40)	(45)
Short-term borrowings	1,727	2,836	2,890	2,407	1,512
Long-term borrowings	229	125	69	-	-
Trade payables	105	195	429	406	472
Provisions	146	256	370	351	406
Total current liabilities	2,183	3,373	3,687	3,161	2,387
Total non-current liabilities	303	201	137	68	68
Total liabilities	**6,127**	**7,808**	**8,690**	**9,131**	**9,660**
Cash and cash equivalents	19	19	30	30	50
Inventory	3,876	5,004	5,383	5,383	5,383
Trade receivables	1,069	1,914	2,156	2,450	2,789
Other current assets	679	361	456	532	618
Total current assets	**5,643**	**7,298**	**8,025**	**8,395**	**8,840**
Gross block	639	688	784	896	1,026
Less: depreciation and amortization	346	341	391	448	513
Add: capital work-in-process	14	-	-	-	-
Total fixed assets	307	348	393	448	513
Investments	81	72	155	155	155
Other non-current assets	93	90	117	133	152
Total non-current assets	**484**	**510**	**666**	**737**	**820**
Total assets	**6,127**	**7,808**	**8,690**	**9,131**	**9,660**

Note: pricing as on 14 February 2018; Source: Company, quant Global Research estimates

Consolidated financial statements

Y/E March

Cash flow statement (Rs mn)	FY16	FY17	FY18E	FY19E	FY20E
Operating cashflow					
Pre-tax income	829	937	1,017	1,564	1,944
Add: depreciation and amortization	37	43	50	57	65
Add: interest expense & others (net)	329	189	291	262	178
Less: taxes paid	(269)	(184)	(330)	(469)	(583)
Add: inventory changes	**(990)**	**(1,128)**	**(378)**	-	-
Add: working capital changes	(431)	(447)	(77)	(412)	(304)
Total operating cashflow	**(495)**	**(590)**	**573**	**1,001**	**1,299**
Investing cashflow					
Capital expenditure	(52)	(81)	(96)	(112)	(130)
Investments	87	8	(83)	-	-
Others	(79)	15	(329)	(291)	(209)
Total investing cashflow	**(44)**	**(57)**	**(508)**	**(403)**	**(339)**
Financing cashflow					
Share issuances	1	-	0	-	-
Loans	896	1,005	(2)	(553)	(895)
Less: Others	(364)	(359)	(52)	(46)	(46)
Total financing cashflow	**533**	**646**	**(54)**	**(598)**	**(940)**
Net change in cash	**(5)**	**(1)**	**11**	**-**	**20**
Opening cash	25	19	19	30	30
Add: other adjustments	-	-	-	-	-
Closing cash	**19**	**19**	**30**	**30**	**50**

Growth ratios (%)	FY16	FY17	FY18E	FY19E	FY20E
Net revenue	16.0	13.5	18.5	16.6	16.1
EBITDA	24.1	18.2	6.8	38.2	16.1
Net profit	27.8	17.2	11.5	59.7	24.4
Ratios (%)					
Effective tax rate	37.0	36.5	32.5	30.0	30.0
EBITDA margin	**28.8**	**30.0**	**27.0**	**32.0**	**32.0**
Net profit margin	13.9	14.4	13.6	18.6	19.9
Net debt/equity	0.5	0.7	0.6	0.4	0.2
ROaCE	20.9	19.0	17.3	22.4	24.7
Total inventory turnover ratio (x)	1.1	1.0	1.0	1.1	1.3
Total asset turnover ratio (x)	1.1	1.0	1.0	1.0	1.0
Payable days	11.8	19.9	45.0	45.0	45.0
Debtor days	104	164	156	152	149
Per share numbers (Rs)					
Diluted earnings	19.2	22.6	25.1	40.1	49.9
Cash earnings	0.72	0.69	1.10	1.10	1.84
Free cash	(20.1)	(24.7)	17.5	32.7	43.0
Book value	134	157	180	219	267
Valuations (x)					
EV/Sales	4.2	4.0	3.4	2.8	2.3
Price to diluted earnings	26.8	22.8	20.5	12.8	10.3
Price to book	3.84	3.28	2.86	2.36	1.93

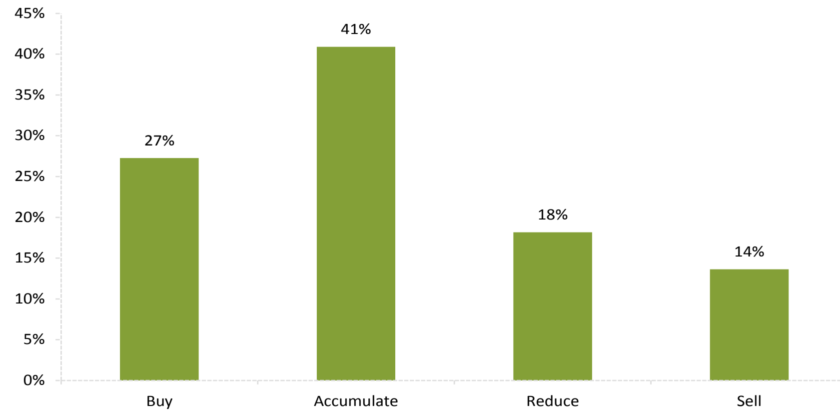
Note: pricing as on 14 February 2018; Source: Company, quant Global Research estimates

RATINGS AND OTHER DEFINITIONS

STOCK RATING SYSTEM
BUY. We expect the stock to deliver >15% absolute returns.
ACCUMULATE. We expect the stock to deliver 6-15% absolute returns.
REDUCE. We expect the stock to deliver +5% to -5% absolute returns.
SELL. We expect the stock to deliver negative absolute returns of >5%.
Not Rated (NR). We have no investment opinion on the stock.

SECTOR RATING SYSTEM
Overweight. We expect the sector to relatively outperform the Sensex.
Underweight. We expect the sector to relatively underperform the Sensex.
Neutral. We expect the sector to relatively perform in line with the Sensex.

INSTITUTIONAL EQUITIES RESEARCH COVERAGE UNIVERSE – DISTRIBUTION OF RATINGS



DISCLOSURES AND DISCLAIMER

quant Broking Private Limited, Mumbai, India (Hereinafter referred to as “QBPL”) is Registered Member of National Stock Exchange of India Limited and Bombay Stock Exchange Limited. QBPL is also registered as Depository Participant with NSDL. QBPL is an registered entity as Research Analyst under SEBI (Research Analyst) Regulations, 2014. QBPL or its associates has not been debarred/ suspended by SEBI or any other regulatory authority for accessing /dealing in securities Market.

ANALYST(S) CERTIFICATION

“I, Ankit Pande, CFA, Research Analyst, hereby certify that all of the views expressed in this Research Report accurately reflect my personal views about all of the issuers and their securities and no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this research report.”

As per the declarations given by the Research Analyst(s) and/or any of his family members do not serve as an officer, director or any way connected to the company/companies mentioned in this report. Further, he/they has/have not received any compensation neither for investment banking/merchant banking/brokerage services or other products/services nor for benefit of him/them or third party in connection with research report and also have not managed or co-managed public offering of securities from the company or its associates in the preceding twelve months. The Research Analysts or company or its associates do not have actual/beneficial ownership of one per cent or more securities of the company. Our entire research professionals are our employees and are paid a salary and they are not engaged in any market making activity. The Reserch Analyst or company or its associates do not have any financial interest in the company. They do not have any other material conflict of interest of the Research Analyst or member of which the Research Analyst knows of has reason to know at the time of publication of the research report or at the time of the public appearance.

The Research Analyst(s) are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter “SEBI”) and the analysts’ compensation are completely delinked from all the other companies and/or entities of quant Broking Private Limited (QBPL), and have no bearing whatsoever on any recommendation that they have given in the Research Report.

This Research Report (hereinafter called “Report”) is meant solely for use by the recipient and is not for circulation. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Similarly, this document does not have regard to the specific investment objectives, financial situation/circumstances and the particular needs of any specific person who may receive this document. The securities discussed in this report may not be suitable for all investors. This report is for information purposes only and this document/material should not be construed as an offer to sell or the solicitation of an offer to buy, purchase or subscribe to any securities, and neither this document nor anything contained herein shall form the basis of or be relied upon in connection with any contract or commitment whatsoever. This document does not solicit any action based on the material contained herein.

Disclaimer

This Report has been prepared on the basis of publicly available information, internally developed data and other sources believed by QBPL to be reliable. QBPL or its directors, employees, affiliates or representatives do not assume any responsibility for, or warrant the accuracy, completeness, adequacy and reliability of such information, opinions/views. While due care has been taken to ensure that the disclosures and opinions given are fair and reasonable, none of the directors, employees, affiliates or representatives of QBPL shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way whatsoever from the information/opinions/views contained in this Report. This Report is provided for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this Report should make such investigation as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this report (including the merits and risks involved), and should consult his own advisors to determine the merits and risks of such investment. Though disseminated to clients simultaneously, not all clients may receive this report at the same time. The projections and forecasts described in this report were based upon a number of estimates and assumptions and are inherently subject to significant uncertainties and contingencies. Projections and forecasts are necessarily speculative in nature, and it can be expected that one or more of the estimates on which the projections and forecasts were based will not materialize or will vary significantly from actual results, and such variances will likely increase over time. All projections and forecasts described in this report have been prepared solely by the authors of this report independently of the Company. This information is subject to change without any prior notice. QBPL or any of its affiliates/group companies shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. QBPL is committed to providing independent and transparent recommendation to its clients. Neither QBPL nor any of its affiliates, group companies, directors, employees, agents or representatives shall be liable for any damages whether direct, indirect, special or consequential including loss of revenue or lost profits that may arise from or in connection with the use of the information. The information given in this report is as of the date of this report and there can be no assurance that future results or events will be consistent with this information.

The price and value of the investments referred to in this Report and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance. QBPL does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding taxation aspects of any potential investment. Opinions expressed are our current opinions as of the date appearing on this Research only. We do not undertake to advise you as to any change of our views expressed in this Report.

QBPL and/or its associates and/or employees and/or Clients may; (a) from time to time, have long or short positions in and buy or sell the investments in/security of Company(ies) mentioned herein or (b) be engaged in any other transaction involving such investments/securities of company(ies) discussed herein or act as advisor or lender/borrower to such company(ies) these and other activities of QBPL and its associates or employees may not be construed as potential conflict of interest with respect to any recommendation and related information and opinions. Without limiting any of the foregoing, in no event shall QBPL and its associates or employees or any third party involved in, or related to computing or compiling the information have any liability for any damages of any kind.

Regn. No.:	
CAPITAL MARKET SEBI REGN. NO.: BSE: INB011419430	EQUITY DERIVATIVES SEBI REGN. NO.: BSE: INF011419430
CAPITAL MARKET SEBI REGN. NO.: NSE: INB231419434	FUTURES AND OPTIONS SEBI REGN. NO.: NSE: INF231419434
CURRENCY DERIVATIVES SEBI REGN. NO.: NSE: INE231419434	

Member	**(NSE and BSE)**
Depository Participant (DP)	NSDL DP ID: IN303614
Website	www.quantcapital.co.in
Compliance Officer Details:	Drishti Shah Tel: (022) 4088 0100; Email: drishti.shah@quantcapital.co.in

QUANT BROKING PRIVATE LIMITED (CIN: U67110MH2007PTC291657)	
Registered Office	612, Maker Chambers IV, Nariman Point, Mumbai 400 021, India | phone 91 22 4088 0100 | fax 91 22 4088 0249-250

Thank you

Ankit Pande, CFA
ankit.pande@quantcapital.co.in
91 22 4088 0380

612, maker chambers IV, nariman point,
mumbai 400 021, india
phone 91 22 4088 0100, 3025 0100
fax 91 22 4088 0198, 3025 0198

analysis adds up