Saregama: Can it churn out a chartbuster?

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Saregama: Why not to invest

Key arguments that I hear for not investing in Saregama are

- Caravan has done well but it will not scale up and survive in the world where people are moving to digital content consumption hence there is no terminal value to business

- Movie business is very risky and unpredictable…it can wipe out all the good work done by the company in other areas

- Saregama has only old content which will become less and less relevant going forward and value of catalogue will diminish over time

A Variant view on Saregama

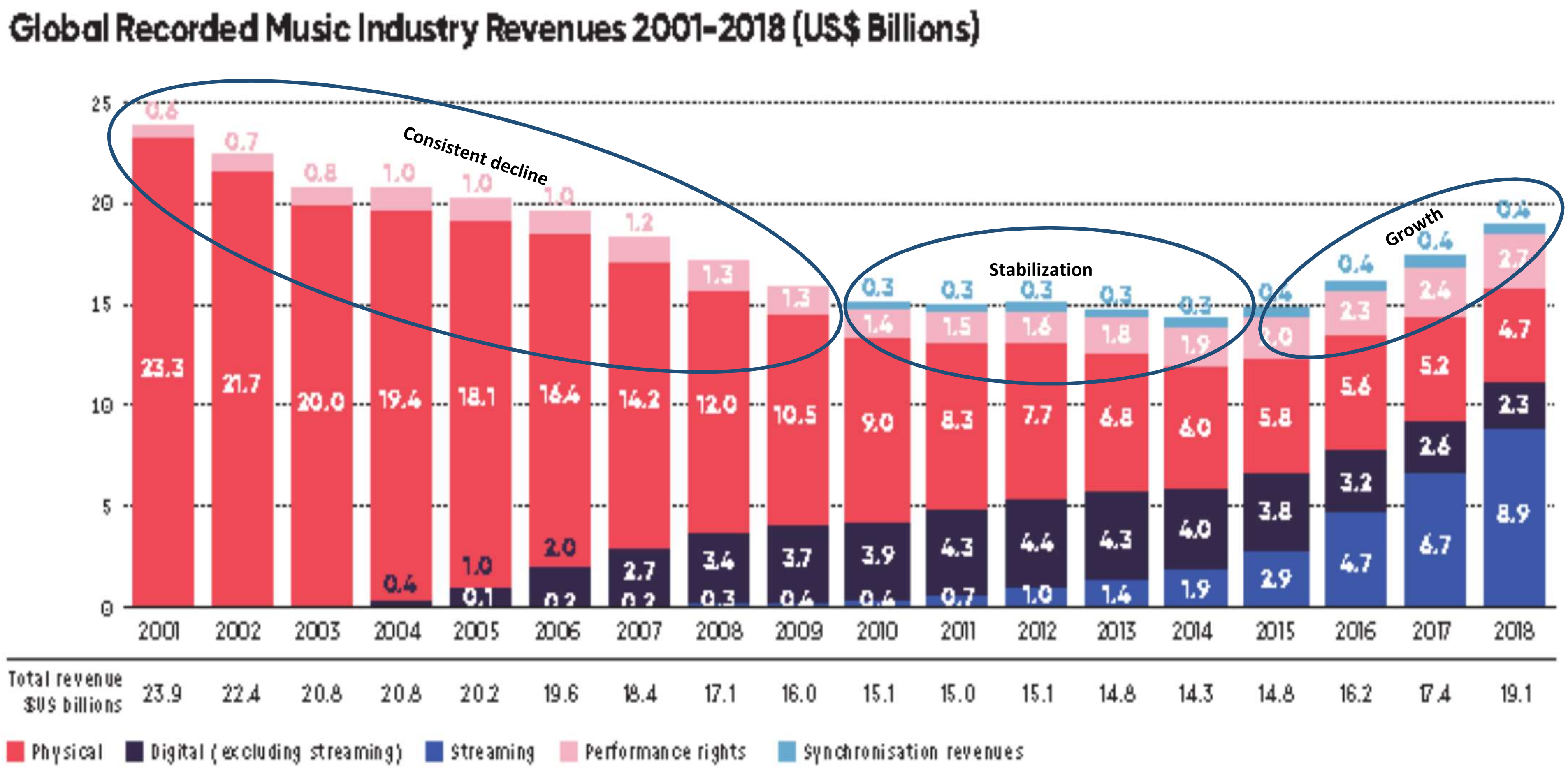
- Saregama is NOT a story about Caravan’s success and scale up. In fact the most interesting aspect of Saregama’s story is also the most underrated..i.e. the consistent scale up in licensing revenue and huge tailwind on streaming revenues

- Yoodlee films is a “Heads I win big, Tails I don’t lose much” proposition – it has been immensely successful in past (Miramax)

- In Indian music industry “performance rights” portion is not duly monetized in past- however it is likely to change soon(in fact it is already changing!) and almost entire additional revenue can flow to bottom line!

- Saregama library is not ONLY about retro music…In fact post 90s catalogue constitutes 48% of overall catalogue for company. Moreover, after a hiatus of a decade, Saregama has re-started acquiring new content and is scaling up well..with an idea that company wants to be relevant for listeners 2 decades from now

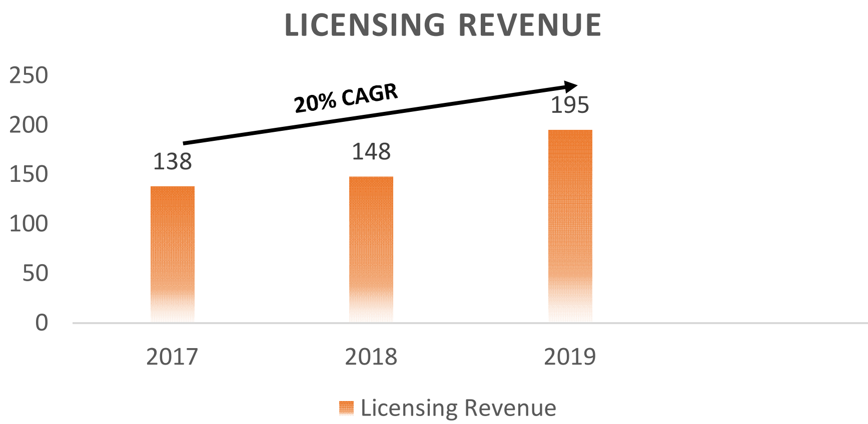
Digitization of music: Harbinger of growth for the industry

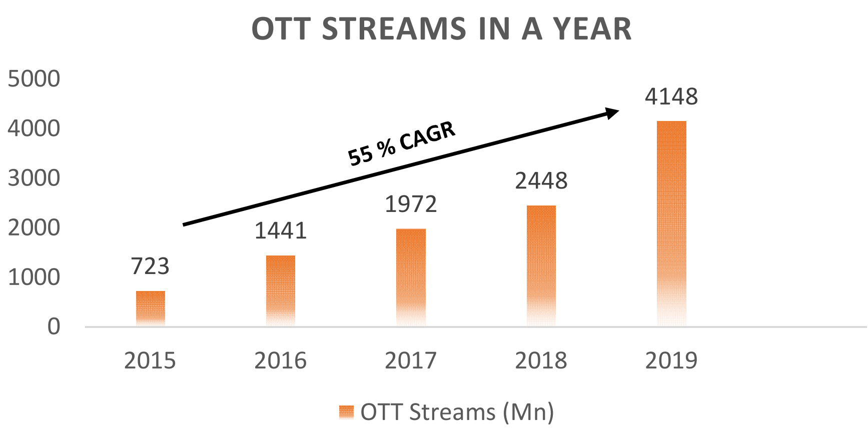


Why streaming has helped music industry regain its mojo?

- Piracy in music is coming down increasingly with proliferation of streaming – driving factors for the change in behaviour
  - Affordability: unit economics
  - Accessbility: ease of access
  - Selection: Personalization
  - Consumption of pirated music has come down from 38% in 2013 to 32% in 2018 – A significant improvement considering past trend
- Business model of music catalogue companies has evolved
  - Revenue model has shifted from one time sale (Cassette/CD etc) to more sustained and longer duration revenue stream (each time song is played music catalogue company earns revenue)
  - Even though per stream monetization is fraction of a CD/cassette sale- frequency of monetization has jumped multifold- making it a consistent revenue stream for catalogue
  - Target audience has broken geographical barrier – increasing the monetization opportunity
  - Cash flow are back ended but more durable and consistent
- Valuation multiple for music catalogue has jumped due to more predictable and stable cash flow
  - Till 2014-15, music catalogue companies have been valued at 8-12 times Net Producer's Share (Royalties earned by catalogue company – Royalty paid out to artists). However, Since 2016, valuations multiples have increased by at least 50% - i.e. 12-18 times
  - Sony deal of EMI – EV of USD 5 billion – (USD 663 million FY 18 Revenue – 8 times EV/Sales and approximately 16 times NPS); Kobalt Capital acquisition of SONGS catalogue- also happened at similar valuations

Saregama: Publishing business on growth trajectory





- In spite of Saregama getting out of mobile VAS business (which was 20-25% of revenue in FY 17), company has grown licensing revenue at 20% CAGR
- No of OTT streams has increased at 55% CAGR over last 4 years
- Music streaming market is still nascent considering three major players Amazon Music, Spotify and Youtube Music have actively started exploring market only in last 12 months
- Management has guided 40%+ growth in streaming revenue for next few years

Yoodlee Films: Asymmetric payoff possible

- Yoodlee films is working on a very different business model than a typical production house on account of
  - Producing a movie on low budget (3-5 Cr/movie) and tight timeline (1 movie a month) where the focus is on strong storyline and not on "A" list start cast
  - Movie is targeted to be released on digital platforms/broadcasting networks and not in theatres – pruning out marketing/distribution cost
  - Key personnel (actors, director, writer) are roped in on profit sharing model and low upfront cost- aligning incentives for the success of the movie while making it possible to produce movie in tight budget
  - Miramax model – Immensely successful in 1990s; Many Indie movie studios are flourishing on same model due to digital ecosystem - Netxlix, Amazon, Disney, Apple, Sony Pictures,HBO buy such content
- Yoodlee films:
  - Completed 5 movies in FY 19 and licensed all of them to Netflix – 5 other movies are at different stages of production
  - Signed an output deal for 12 movies with hotstar – taking off the risk with assured revenue- deals done with potential margin of 20-25%; Another output deal on cards
  - In all above deals – IP of the movie remains with Saregama while the digital platform gets streaming rights for fixed period
  - 100% cost of movie is charged off through P&L in the year the movie deal is signed
  - At the end of 4-5 years it will have a catalogue of 50-60 movies which have been completely charged off P&L and revenue generated in second cycle directly flows to bottomline
  - One or two successful movies can change the P&L significantly (e.g.: The birth of nation – Production cost:USD 1 Lakh, Sold movie for USD 17.5 Million) – Asymmetric payoff

Performance Rights: A Joker in the pack

- Where is performance right royalty applicable? – Public appearances, private events & functions
  - E.g.: Public concerts, Musical evenings, DJs playing at party/events etc
- Globally, average 15% of revenue of the music industry comes from the performance right royalty while that is negligible for Indian music industry
- Copyright law amendment in 2012- opened the gate for charging royalty for performance rights
- Since then there was dispute about how the collected royalty should be distributed between artists and music label companies. The fight was amicably settled in 2017 with both parties agreeing to share royalty
- From 2018 onwards both IPRS and PPS (two societies registered as authorized body to collect money on behalf of the industry) have started collecting money for performance rights
- It is estimated that both societies may collect around 200 crore in royalties in FY 20/FY 21. Music label company's share of royalty will be almost half. Thus around 100 crore will be shared among 4 major music label companies. Even though exact proportion will be difficult to determine for particular music label company- ball park number can be in 20-25 Cr.
- The royalty accrued has no additional cost and hence can flow to PBT level

Why is it attractive at current price?

- Total Market cap: 934 Crore ; Total debt: 25 Crore: Enterprise Value: 960 Crore

- Catalogue valuation

    - Total revenue generated: **195 Crores**
    - NPS (Typically it is 50% of revenue but considering older library it may be higher for Saregama)- **100 Crore** (around 50%)
    - Catalogue valuation is at lower end of acquisition cost: **10 times NPS**
    - Globally music catalogue companies are growing revenue at 6-8% and are valued at 12-18 times NPS while Saregama is growing catalogue revenues at 20%+ and is still valued at 10 times NPS

- Upside from Yodlee films and performance rights remain optionality
- **We are not even considering "Caravan" sustaining the momentum and scaling up – Management has guided to sell 5 million Caravan in next 3 years vs cumulative sales of 1.2 million in last 2 years. Assigning zero value to it as of now.**

- Vikram Mehra – A competent jockey at the helm with skin in the game

Risks that can derail the hypothesis

- Capital allocation: RPG group doesn’t have stellar track record of capital allocation
    - Oped magazine continues to bleed and yet it is not divested/sold

- New music acquisition: Overpaying for titles and not generating good IRRs

- Shift from “pirated” to “authorized streaming” reversing

- Distribution platforms arm-twisting music labels squeezing out margins and brining down payouts