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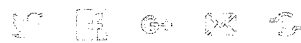
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## Former Eros Co-Producer Accuses Company of “Channeling Money to Family Members”

Posted on March 8, 2017

1 Comment



Contributed by FG Alpha Management for GeolInvesting, LLC

### Summary

- An amended class action securities complaint cites testimony from an Indian filmmaker and Eros International (NYSE:EROS) co-producer as a confidential witness
- This confidential witness claims that “Eros channels money to family members through dummy production deals”
- This claim seems to lend validation to longstanding allegations of fraud and misdealing made against Eros by various short sellers
- The company’s LeEco prepaid phone bundling partnership, supposedly responsible for a substantial amount of paid ErosNow subscribers, has come and gone without explanation from management
- The company’s struggles with collecting on its accounts receivable continue and we call into question the company’s ability to ever achieve a cash flow neutral or cash flow positive position

In this article, we plan on providing what can only be described as explosive evidence from a former Eros (EROS) co-producer and Indian filmmaking expert that seems to validate numerous outstanding allegations of potential fraud and misrepresentation made by short-sellers over the course of the last two years. We have uncovered allegations from an amendment to a securities class action lawsuit filed against the company, wherein a confidential witness and former co-producer for Eros makes the claim that the company is “channeling money to family members” through production deals with a related party.

On top of these stunning claims, we also want to pose extremely important questions about the details of the company’s pre-paid ErosNow bundle on LeEco phones that appear to have been “conveniently” swept under the rug over the course of the last few quarters. We will not only call into question numbers provided by the company, but also the lack of disclosure from the company regarding termination of the LeEco partnership.

Finally, we’ll look at statements made by management during the company’s earnings presentation on February 21, 2017. We believe these statements and the numbers presented only provide ammunition for the case that the company may not be financially viable and we believe that its earnings report provides red flags regarding the company’s near-term outlook.

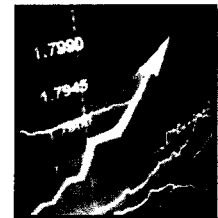
### Whistleblower: Company “Channels Money to Family Members”

On November 15, 2015, a class action securities lawsuit was filed against Eros, its key principals, and its IPO underwriters alleging fraud related to NextGen, a production company controlled by Eros’ founders and the founders’ family. An amended complaint filed July 15, 2016 cited testimony from a confidential witness (“CW2”) that had knowledge of the NextGen relationship. From the complaint:

“Confidential Witness (“CW”) 2 is an Indian film producer who has co-produced films with Eros, including at least one film released in 2011, and is thus aware of Eros’s business practices from having worked with the Company and from CW2’s knowledge and experience in the Indian film industry. According to CW2, Eros channels money to family members through dummy production deals. According to CW2, 30-40% of Eros’s acquisition and production occurs through NextGen, owned by Kishore Lulla’s brother-in-law Pujja Rajami. Further, according to CW2, NextGen signs the co-production agreements with EIM (Eros International Media Ltd.), and Eros makes payments to EIM, which, in turn, makes payments to NextGen to produce the films. Thus, NextGen collects money on films but provides no added value, according to CW2. CW2 also avers that NextGen employees use Eros’s offices and do little other than make a margin on the film.”

*"I'm a big fan of your work and I can't believe how many doubles, triples and home runs you guys hit." Chris*

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As Seen In

Allegations of self-dealing have been public since October 30, 2015 when author Alpha Exposure published a scathing article on Eros. The article claimed that the company had "enriched its controlling family at the expense of shareholders through a series of related party transactions" and concluded that Eros stock was "worthless".

Now we have yet another, more powerful echo of self-dealing allegations coming from an insider in the industry. According to the insider, NextGen is simply being used as a conduit to siphon money from company shareholders into the coffers of the Lulla family.

Following criticism of these transactions, the company reduced its 2016 related party transactions and only purchased \$2,728,000 in film rights from NextGen. However, according to recent quarterly filings, the company appears to be ramping back up, with plans to release at least 3 major pictures with NextGen.

On a related note, one might imagine that perhaps the easiest money to account for would be that which you pay to yourself. But according to filings the company can't seem to decide exactly how money they've paid themselves through NextGen. In the annual 20-F filings, the amount of film rights sold to the company by NextGen in 2014 has changed in every filing:

- Fiscal year 2014 filing: \$12,483,000 in film rights sold by NextGen in 2014.
- Fiscal year 2015 filing: \$22,205,000 in film rights were sold by NextGen in 2014.
- Fiscal year 2016 filing: \$12,483,000 in film rights were sold by NextGen in 2014.

*(Note that although 2 amended filings were issued for the Fiscal year 2014 and Fiscal year 2015, the NextGen transactions were only changed back to \$12,483,000 in one amendment, while the other remained inconsistent)*

A \$10 million swing in the amount of disclosed self-dealing raises serious questions about the accounting protocols surrounding these transactions and what the true numbers look like.

### Eros' Recent Earnings Report Shows No Signs of Improvement

In fairness, we wanted to look for signs of optimism when the company reported its earnings on Tuesday, February 21, 2017. What we were met with, instead, were statements during the conference call that provided us with anything but a rosy outlook. Aside from the deteriorating balance sheet, there were several additional red flags in this report.

We received no disclosure on the status of Eros' partnership with LeEco and zero insight on the actual ErosNow user base. A full transcript of the company's earnings call can be read [here](#).

The company also came out and confirmed that they expect to be cash flow negative this fiscal year when they stated:

**"From a liquidity perspective, while we were able to absorb the temporary shock of demonetization on our business, the shift of selected completed films into future quarters combined with our content investment means we do not expect to be free cash flow positive by the end of this current fiscal year."**

What we also found to be questionable was the fact that digital revenues continue to decline while ErosNow, the company's digital streaming platform similar to Netflix, is supposedly gaining so many "paid subscribers":

**"For the three months ended December 31, 2016, the aggregate revenues from digital and ancillary decreased by 22.5% to \$17.2 million from \$22.2 million for the three months ended December 31, 2015."**

Either paying subscribers are not a meaningful contributor to revenue, pricing pressures have intensified, or there are other forces at play.

While many people argue that companies like Netflix are not good investments because they can't fill out their valuation in terms of eventual cash flow, one thing that they can always consistently show is that revenues are moving higher consistent with the number of subscribers. For EROS, this doesn't seem to be the case.

We noted net income for the period of \$11,484 includes \$10,264 of "other" income which is related to held-for-trading financial liabilities. We were unable to find specifics on what these are anywhere (except that they are derivative instruments held for sale).

The company's DSO this quarter spiked to 323.9 days. For context, the S&P 500 average DSO is 50.8, and if Eros were in the S&P 500 they would rank #499 in DSO.

In its financial filings, Eros reports "Revenue by Customer's Location" which breaks down customer locations as India, Europe, North America ("N.A.") and Rest of World ("RoW"). As shown below:

BUSINESS  
INSIDER

WALL STREET  
JOURNAL

BARRON'S

FT  
FINANCIAL TIMES

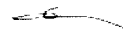
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## Revenue by Customer Location

Segment	Q3 FY '17	Q3 FY '16	Change
India	24,810	33,603	-26.17%
Europe	1,464	6,228	76.49%
North America	4,528	5,265	-14%
Rest of World	26,546	15,356	72.91%

The data has several flagrant anomalies. RoW revenues in the recent quarter are higher than India revenues for a company that makes Bollywood movies. India has 1.25 billion Indians. According to the latest UN report on migrants the entire Rest of World (including Europe and North America) has about 16 million ex-pat Indians in addition to natural born people of Indian descent. The numbers, like many of Eros' numbers, simply don't make sense to us.

Demographic questions aside, RoW managed to lock in a massive 72.87% year over year revenue increase despite double-digit year over year declines for every other geographic segment.

The company's overall revenue also declined in the most recent quarter despite the RoW gains. The company largely attributed the overall quarterly revenue decline to demonetization. Demonetization is an anti-money-laundering effort undertaken by the Indian government whereby cash is removed from the monetary system in order to stimulate the use of more formal electronic banking systems. Due to the lack of cash circulating the economy, the company chose to release fewer films rather than premier films in an environment where consumers were less likely to be able to pay for them.

In light of this headwind, Eros stated that the RoW revenue increase was "mainly due to *decreased* theatrical revenues from the film mix offset by *increased* catalogue revenues." In other words, RoW sales of old media content from their catalogue were so substantial that they were able to overcome the decline in theatre revenues and *still* produce a combined 72.87% growth in the segment. This seemingly random spike in sales of catalogue content in a non-core market is *highly* dubious.

Eros' financial statements have always had a strange relationship with its catalogue revenues. They've described them as having both "high margin" and having "relatively longer payment cycles." The payment cycles are apparently so long that in fiscal 2016 the company actually decided to "forego a portion of their potential catalogue revenues that have relatively longer payment cycles, in order to improve days sales outstanding."

The explanation is befuddling. High margin sales are by definition the most profitable and desirable type of sales. While DSO is an indication of potential issues relating to receivables collection, halting profitable sales simply to effect a temporary improvement in a balance sheet ratio is entirely nonsensical.

Quite simply, we don't have any faith in the "high margin" RoW catalogue sales that (i) never seem to get collected (ii) contravene the revenue growth trends of all other segments of the company and (iii) exist in the least regulated, most opaque jurisdictions.

At the end of the day, it simply doesn't seem like EROS is showing any signs of refuting any short seller allegations made over the last year, nor do they show signs of a fundamental turn around in their business. The most recent quarter leaves us with far more questions than answers.

## Major Partnership Disappears With No Disclosure

In a 6-K filed June 30, 2016, the company announced results of operations for the fourth quarter and fiscal year ended March 31, 2016. The report proclaimed "Eros Now has garnered over 44 million registered users". The announcement did not cite the specific number of *paying* subscribers, but instead stated:

*"The Company continues to progress in converting its registered users to paying subscribers, currently at under 1% of its user base."*

Less than 1% implies a registered user-base ranging somewhere between 0 and 440,000, given the company's stated total user base at the time. The company added that it "expects to reach 1 million paying subscribers by the end of Fiscal 2017."

In the same filing, Eros describes strategic partnership agreements which mostly consisted of deals with various hardware and telecom providers whereby Eros would be pre-installed on phones. However in one partnership with a provider named LeEco, Eros was to be part of a *prepaid* content bundle.

*"Eros Now is integrated on LeEco phones for the Indian market with a one year Eros Now subscription worth approximately \$10 and \$20 pre-bundled on standard and premium handsets, respectively. LeEco smart phones, LeMax and Le1S are being exclusively sold through ecommerce portal Flipkart and LeEco is running an aggressive marketing campaign in India. A portion of the paid subscribers from this deal should reflect in the next paid subscribers update made by Eros Now."*

In an earlier corporate presentation dated March 2016, a section describing the LeEco partnership touted "LeEco's smart phones received over 800,000 pre-registrations in the first 30 days of launch."

## Q3 FY 2016 Operational highlights



**Film Slate:** The Company's strong portfolio of films drove theatrical, television and digital ancillary revenues worldwide with *Barahna Bhaagari*, *Barahna Master* and *Taru Weeds Manu Returns* taking No. 1, No. 2 and No. 4 positions on the box office charts with other blockbusters giving films a total of seven out of the Top 10 box office films in Calendar Year 2016.

**Trinity Pictures:** Over the last 12 months, Trinity has developed over 10 stories in-house in the Company's Order 5. Budget and greenlit after audience testing. Of these, at least four will be in production in Fiscal Year 2017, two of which will be India-China productions, shot in both India and China and in both languages.

**ErosNow Registered Users:** The platform continues to demonstrate strong growth, gaining over 37 million registered users across WAP, APP and Web. The Company's new two-tier premium pricing in India launched in December 2015 and is gaining traction. The Company continues its progress in converting its registered users to paying subscribers, currently at under 1% of its user base, and expects to reach **1 million paying subscribers** by the end of Fiscal Year 2017.

**ErosNow Platform Distribution:** The Company announced a deal with **LeEco**, where ErosNow would be integrated on LeEco phones with a one-year ErosNow subscription pre-bundled on handsets. LeEco smart phones have already received pre-registration of over **800,000** within 30 days of launch. The Company's telecom integration strategies with ErosNow powered by **Airtel** (which has the largest market share of internet subscribers in India) and **Idea Cellular** (which has the third largest market share of internet subscribers in India) are also gaining momentum.

It was the only strategic partner in the presentation where any number of users or subscribers were quantified. Also note that out of all 9 strategic partnerships mentioned in the announcement, **Eros only stated that the LeEco deal should reflect in the next paid subscribers update.**

And reflect it did. Whereas Eros earlier had targeted 1 million paying subscribers for ErosNow in the full year, in the subsequent **quarter (ending June 2016)** the press release headline stated:

### Eros International Plc Reports Results for First Quarter FY 2017

*Eros Now crosses full year target of 1 million paid subscribers in the very first quarter of FY 2017*

Telecom. UK, September 8, 2016. Eros International Plc (Eros) reports its first quarter FY 2017 results. Eros Now registered users have crossed 37 million and Eros Now paying subscribers have reached 1.32 million.

The company declined to explain how they defined a "subscriber", or to confirm the source or details of their newfound 1 million+ subscribers, but given the prior quarter's statement and the promotional announcement, it can be inferred that a substantial portion of the paying subscribers came through the **LeEco deal**. In the next quarter (ending September 2016), the headline of the press release announced **1.32 million paying users**:

Exhibit 96-1



### Eros International Plc Reports Second Quarter Fiscal Year 2017 Results

*Eros Now paying users reach 1.32 million - 20% growth from last quarter*

Coupled with that pronouncement, a new footnote emerged in fine print on the subsequent page:

**"Paying subscribers means any subscriber who has made a valid payment to subscribe to a service that includes the Eros Now service either as part of a bundle or on a standalone basis, either directly or indirectly through a telecom operator or OEM in any given month be it through a daily, weekly or monthly billing pack, as long as the validity of the pack is for at least one month."**

2. Paying subscribers means any subscriber who has made a valid payment to subscribe to a service that includes the Eros Now service either as part of a bundle or on a standalone basis, either directly or indirectly through a telecom operator or OEM in any given month be it through a daily, weekly or monthly billing pack, as long as the validity of the pack is for at least one month.

In other words, every LeEco phone (which came with Eros as part of the pre-bundled content) was likely counted as a 'paying' subscriber. That same quarter, the company upped the ante on its paid subscriber estimates:

**"We believe we are on track to achieve at least 2 million paying subscribers by end of fiscal 2017."**

Although the LeEco deal seemed to be giving the company a basis for reporting surging paid subscribers, not all was going smoothly with the roll-out. Following the initial announcement of the strategic alliance between Eros and LeEco on January 20, 2016, on July 13, 2016 the Indian technology site Digit reported that the integration with Eros Now was not complete, and that it was **unable to play movies**.

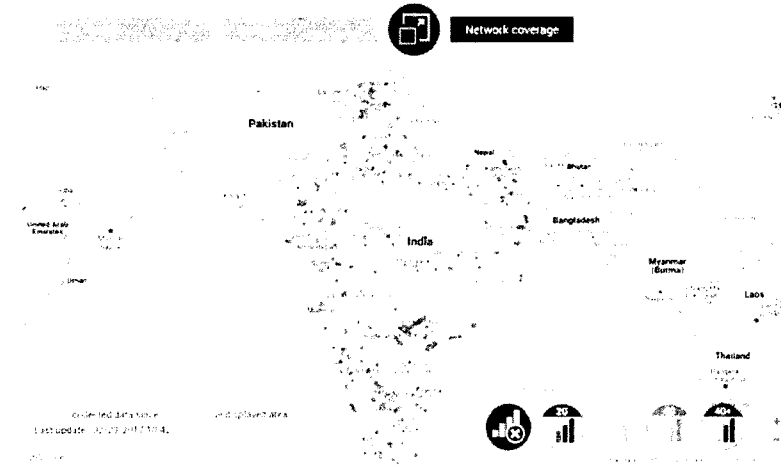
**"...it seems the Eros Now integration isn't quite complete, yet. We couldn't play Eros Now movies, but that's definitely because of the beta UI and final versions should have it fixed."**

Earlier in May 2016, Indian media reported that the biggest challenge is to make content run smoothly for users in India

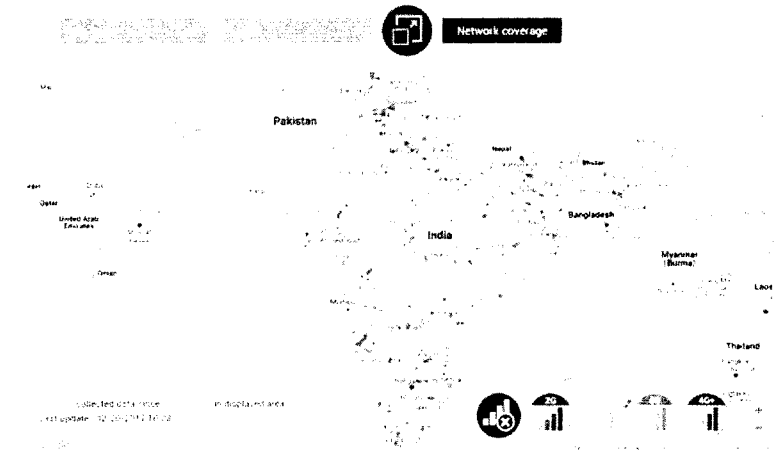
“...who are still on 2G or end up getting 2G-like speeds even on a 3G network.”

This begs the question: if Eros Now didn't work on LeEco's 2G/3G network, how would it have performed *anywhere* in India? We looked at coverage maps of India's top 2 cell phone carriers (Vodafone and Airtel, combining for over 500 million subscribers), which show that 4G is almost nowhere to be found in the country yet, with a majority of service supporting only 2G and 3G.

**Vodafone:**



**Airtel:**



Only Jio's new and upcoming service coverage touts widespread 4G, as the company offers *only* 4G service. Jio has plans to spread 4G across the country which may prove helpful in the coming years once the country's infrastructure is upgraded. However, Jio is still only 4th in total subscribers, behind names like Airtel and Vodafone, which together encompass more than 5 times Jio's current total subscriber base.

Rank	Operator	Technology	Subscribers (in millions)	Ownership
1	Airtel	GSM-900/1800 (EDGE) 2100 MHz UMTS, HSPA+ 850/1800 MHz LTE, LTE-A 2300 MHz TD-LTE	317.35 <sup>[36]</sup>	Bharti Airtel SingTel (32.4%) <sup>[36]</sup>
2	Vodafone	GSM-900/1800 (EDGE) 2100 MHz UMTS, HSPA+ 1800 MHz LTE	202.79 <sup>[35]</sup> (Nov 2016)	Vodafone
3	Idea Cellular	GSM-900/1800 (EDGE) 2100 MHz UMTS, HSPA+ 2300 MHz TD-LTE	167.67 <sup>[35]</sup> (Nov 2016)	Aditya Birla Group (49.05%) Axiata Group Berhad (19.96%) Providentia (6.8%) <sup>[37]</sup>
4	Jio	850/1800 MHz LTE 2300 MHz TD-LTE	100.7 <sup>[38]</sup>	100% (state-owned)

It is unclear whether the Eros Now integration was ever completed, but at this stage it appears to be a moot point: on January 28, 2017, the Indian technology site PhoneRadar reported that the Eros/LeEco partnership had quietly ended. Users had begun noticing that pre-paid content no longer appeared on their phones, so they confirmed through an email to the company that the partnership had ended:

“LeEco, the Chinese conglomerate which entered into India last year with their smartphones as well as SuperTV range in the country has silently ended up their partnership with

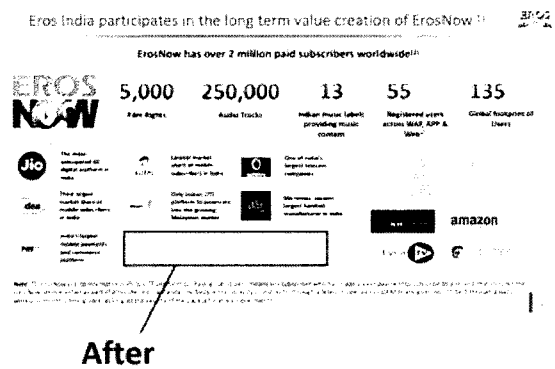
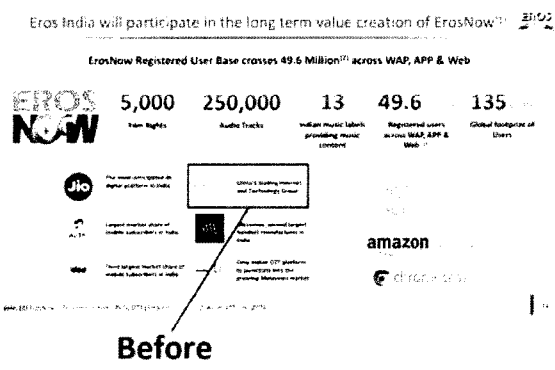
ErosNow. The partnership which was announced by the company when they entered into the country has sadly come to an end. The brand in an email statement released to Phone Radar quoted that they are no longer offering ErosNow catalogue of movies on their SuperTVs and Le Smartphones."

Despite the likelihood that LeEco represented a substantial portion of Eros Now's supposed "paying" subscriber base, Eros apparently chose not to inform its investors "head-on" of any of these material events.

Instead, the company seemingly chose to ignore the event. On February 10, 2017, Eros' Indian subsidiary filed its quarterly results. An updated corporate presentation touted that "ErosNow has Over 2 Million Paid Subscribers Worldwide". The term includes a footnote with the same description of "paid subscriber" as listed above.



The only hint investors received about the apparent dissolution of the major strategic partnership that likely accounts for many of those 'paid subscribers' appears on the page showing the logos and descriptions of different strategic partners. In the quarterly filing dated November 10, 2016 we see the logo of LeEco, whereas in the filing dated February 10, 2017 it is no longer there.



Eros indicated in the above quote that its subscriptions for Eros Now were one year in length. We should reasonably expect to continue to see attrition from Eros' paid subscriber numbers over the next few quarters, given that these LeEco bundled "subscribers" should drop off now that the partnership has ended.

**Conclusion**

These red flags in question speak for themselves. We know that we aren't the first group to raise critical questions about EROS, but the newly disseminated court documents that appear to show an insider affirming previous short seller allegations furthers the case for skepticism when dealing with EROS.

In addition, the company in its most recent earnings report out just days ago, doesn't seem to be showing any signs of stopping its sharp deterioration when it comes to its financial fundamentals. There are still looming questions about it being able to collect on its A/R and many unanswered questions about where – and how – the company is securing its revenue.

Eros' digital revenue numbers simply don't make sense if the company is growing its subscriber base as it claims. The questionable revenue and inability to collect in a timely fashion lead us to believe that the company may not be able to ever achieve a cash flow positive state.

**Disclosure: Short EROS at time of report**

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**Comments**

Steve Ploman says

March 8, 2017 at 6:16 pm

There seems to be nothing new you have covered here (except for LeEco). Everything your reported here is covered by prior short sellers back in 2015 and 2016.

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