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## Eros Loses Investor Love Amid Questions on Sales, User Numbers

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- Shares have plunged by more than half amid fraud allegations
- Eros says claims of exaggerated metrics 'false and malicious'

In Greek mythology, Eros is the god of love. Critics might argue that Icarus, who flew too close to the sun, could be a more fitting name for Eros International Plc, as the Bollywood filmmaker and distributor faces inquiries about its sales and subscribers.

New York-listed Eros has been fielding analyst and investor questions about key metrics for more than a month. They've focused on the number of users who've signed up to its nascent Eros Now online streaming platform, the scale of revenue it books in the United Arab Emirates, and why receivables -- or revenue that's expected but not yet received -- keep climbing.

The stock has been sinking since mid-October, when an anonymous Twitter user called Market Farce began claiming that reported UAE sales aren't legitimate and challenged the company's number for Eros Now customers. On Oct. 23, analysts at Wells Fargo & Co. said they weren't satisfied by answers the company gave on a call held that day to combat the accusations. On Nov. 2, Eros responded to what it called an "anonymous campaign" to negatively affect its stock, saying in a statement that no new facts have come to light regarding its business since the filing of its 2015 financial results, "at which time the market sentiment was extremely positive."

### Detailed Response

"Eros has responded to every false and malicious claim about the company in a very detailed and transparent press release on Monday," Whit Clay, an outside spokesman for Eros at Sloane & Co. in New York, said in an e-mailed statement Wednesday. "Eros is confident in its strategy, operating and financial performance and looks forward to releasing its third-quarter results."

In October, after Wells Fargo cut its target price for Eros shares following the company's call with investors, Clay said Eros wouldn't comment "on an unknown person who hides behind an alias on social media to make ridiculous and outrageous accusations," referring to Market Farce.

Eros has hired the law firm Skadden, Arps, Slate, Meagher & Flom LLP to conduct an independent internal review of its business.

From a peak of \$37.60 in mid-August, equivalent to a market value of more than \$2.2 billion, Eros shares plummeted almost 67 percent to close at \$12.54 on Thursday. On Oct. 30 alone, the shares dropped 13 percent -- the day Citron Research, the short-selling firm that's accused drugmaker Valeant Pharmaceuticals International Inc. of fraudulent practices, said on Twitter that it was "beaten to the punch" on Eros.

## **Knight Flight**

While Eros says its accounting complies with industry norms and denies any wrongdoing, the uncertainty has led to the loss of a key supporter. Knight Assets & Co., a London-based investment firm that until recently owned more than two percent of the company and advocated aggressive expansion of Eros Now, has sold its entire stake, according to a letter to its investors obtained by Bloomberg.

In the letter, which was sent in mid-October, Knight said it decided to sell because “revenues, revenue sources, receivables, intangibles and cash flows” had begun to “flash warning signs,” and that it was unsatisfied with explanations from Eros executives. It highlighted an increase in receivables, which climbed to about \$210 million at the end of the 2015 financial year, from \$112 million a year earlier. Knight said in the letter the firm had been assured by management that “the receivables position would unwind” this year, instead of the opposite.

A representative for Knight declined to comment. In its statement Wednesday, Eros said it hasn’t seen any letter sent by Knight.

## **Longer Terms**

Eros, based in Secaucus, New Jersey, has said the rising receivables figure reflects longer payment terms granted to customers and a broad rise in overall revenue.

“The company’s receivables balance is expected to be approximately 50-55% of revenues by end of FY2016, which is in line with other global content companies,” Eros said in the Nov. 2 statement.

Knight isn’t alone among investors in its concerns. U.S.-based short seller Glaucus Research Group California LLC disclosed Wednesday it has taken a short position in Eros, according to a presentation from Soren Aandahl, the fund’s director of research, at a conference in Chicago. Aandahl said that Eros may be fabricating revenue, a claim that Eros has denied, and that Eros equity is worth “zero.”

Still, not all shareholders believe something is amiss. Los Angeles-based Dalton Investments has boosted its Eros stake to more than 6 percent of outstanding shares from 2.7 percent, it said in an Oct. 23 filing. The fund said it believed the “shares were undervalued and represent an attractive investment opportunity.”

## **Tech Disruption**

The allegations against Eros have disrupted a promising story of emerging-market media and technology adoption, at least for now. Eros produces films starring some of India’s most bankable actors, and is trying to get ahead of Netflix Inc. and Amazon.com Inc. by offering streaming Bollywood content to the country’s burgeoning middle classes through Eros Now.

The idea is to draw on a back catalog of more than 2,000 films and add new original series to create a bulwark against the American players, both of which are expanding their own streaming services globally. One of Eros’s recent films, “Bajrangi Bhaijaan,” made \$77 million in box office revenue and is the second-highest grossing Bollywood film ever.

While the company has upcoming releases to promote, like the historical epic "Bajirao Mastani," it has spent the last few weeks in damage-control mode. It held the Oct. 23 conference call to walk analysts through its accounting, and in the statement this week said there was a "vicious campaign to damage the credibility of Eros International by spreading false rumors and misinformation regarding its business with an objective to create panic."

### **User Count**

Skeptics, including Wells Fargo's Eric Katz, have particularly questioned the number of users Eros says have signed up to Eros Now, which underpin growth projections for the service. It had more than 30 million users at the end of September, Eros has said.

"We're still feeling uncertain about the ErosNow user count," Katz wrote in a note to clients after the Oct. 23 call. "Public websites that track app downloads (i.e. App Annie) show relatively low rankings for ErosNow vs. other Indian streaming services with lower user counts. We can't reconcile the disparity and it's a red flag for investors."

In the note, Katz lowered his price target for Eros to \$20 to \$22 a share from \$48 to \$50.

### **Tax-Friendly**

Katz also has questioned why Eros reports that an increasing proportion of its sales come from the UAE, rather than India. Eros reported fiscal 2015 UAE revenue of \$103.8 million, up from \$45.6 million in 2014 and \$14.5 million in 2013. The sales are based on a customer's domiciled location, according to a company filing.

Market Farce claimed on Twitter the company boosts UAE-based sales in quarters when "their movies don't work."

In response, Eros says Indian buyers of content obtain rights through UAE subsidiaries to avoid tax. That may explain why sales there are rising -- in other words, that Indian companies have chosen to buy its content through tax-haven shell companies. Eros itself has a UAE-based subsidiary, which owns all the international rights to its library.

"Many sub-distributors exploiting Indian content in international territories have companies set up in UAE, British Virgin Islands or similar tax-friendly jurisdictions," Eros said in the Nov. 2 statement. Eros wouldn't disclose the counterparties driving the UAE sales, citing contract confidentiality.

One way for Eros to respond to its critics would be to sell a stake in Eros Now. In July, Bloomberg reported the company was in talks to sell a minority shareholding in the service to Fullerton Fund Management Co., a unit of Singapore state investor Temasek Holding Pte, which could value Eros Now at as much as \$800 million. Those talks are still going on, said a person familiar with the matter. A representative for Fullerton declined to comment.

A deal would reassure investors that Eros's practices are legitimate, Jefferies analyst John Janedis wrote in an Oct. 26 note.

"The nearest term validation for management would be to sell a stake in Eros Now," Janedis wrote. "We assume an investor in 'Now' would be comfortable" with Eros's books, he said.

If a sale goes through at an \$800 million valuation, shares may again pop -- all of Eros International is currently valued at \$775 million. In other words, the Eros Now unit would be worth more than the entire company.

If it doesn't, or does at a much lower value, Eros management may face a new round of questions from investors looking for answers.