ASK | RJ
INDIA EQUITY RESEARCH

4 April 2007

PVR Cinemas

Initiating Coverage **Rs174; Hold**

Sector: Media

Target Price	Rs203
Market cap	Rs4.0 bn/US$92.4 mn
52-week range	Rs337/148
Shares in issue (mn)	22.9
6-mon avg daily vol (no of shares)	40,796
6-mon avg daily vol (mn)	Rs7.1/US$0.2
Bloomberg	PVRL IN
BSE Sensex	12625
Website	www.pvrcinemas.com

Shareholding Pattern (%)

Promoters	40.5
FIIs	28.4
MFs/FIs/Banks	22.8
Others	8.3

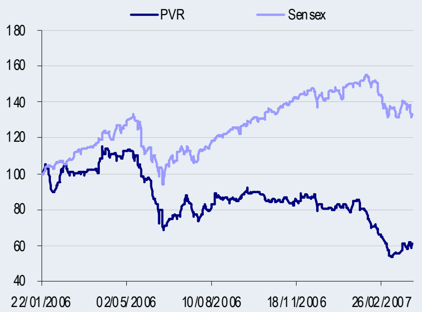
(As of 31 December 2006)

Price Performance (%)

	1M	3M	12M
Absolute	0.0	(24.1)	(46.6)
Relative*	2.1	(14.2)	(55.7)

**To the BSE Sensex*

Relative Performance



(As of 3 April 2007)

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Entertainment at its best, but pricey

Investment highlights

- **Multiplexing in growing northern India:** PVR is a dominant exhibition player especially in the North and presently operates 44 screens of the total 80 screens from the northern belt. PVR is quite a prominent brand in the North, which makes it a preferred multiplex operator.
- **Aggressive growth strategy - Pan India:** PVR is adopting a very aggressive growth strategy to become the largest cinema player in the country and has expansion plans to setup over 110 additional screens over next two years across India barring the eastern region.
- **Revenues to grow at a CAGR of 58% (FY07-FY09E):** We expect the revenue of PVR Cinemas to grow at a CAGR of 58% (FY07-FY09E) to Rs4.03 bn in FY09E on back of vast expansion plans coupled with high appetite for film entertainment among the consumers.
- **EBITDA margin to improve going forward:** We expect EBITDA margin to improve by 230 bps YoY to 16.6% in FY08E and 150 bps YoY to 18.1% in FY09E on back of higher number of future properties under 100% ET exemption and one property in Mumbai with seven screens being introduced on the ownership model.

Investment concerns

- **Fierce competition, location saturation:** PVR faces intense competition with the existing players in the film exhibition business and other fragmented multiplex operators. This would lead to location saturation and subsequently decline average occupancy levels.
- **High dependence on quality film content:** Film exhibition industry is dependent on film content. If the film content going forward is not of high quality which appeals to the audience then PVR would see a decline in its average occupancy number.

Valuations

- **Hold with a target price of Rs203:** The stock trades at 21.7x FY08E earnings and 12x FY09E earnings and at a PEG of 0.23. Although the company is on high growth trajectory and increasing EBITDA margin, we recommend a Hold as there is limited upside from current levels.

Exhibit 1: Financial summary **(Rs mn)**

Y/E March	2005	2006	2007E	2008E	2009E
Net Sales	683	1,049	1,619	2,747	4,032
EBITDA	108	159	232	457	729
EBITDA (%)	15.8	15.1	14.3	16.6	18.1
Net Profit	37	48	89	183	332
EPS (Rs)	1.6	2.1	3.9	8.0	14.5
EPS Growth (%)		27.3	87.4	105.3	80.9
RoCE (%)	6.5	4.3	4.1	9.2	13.0
RoE (%)	8.9	4.2	5.1	10.1	16.6
PE (x)	106.4	83.5	44.6	21.7	12.0
Price/Book Value (x)	5.6	2.3	2.3	2.1	1.9
EV/EBITDA	40.4	26.3	20.5	12.1	8.1
EV/Net Sales	6.4	4.0	2.9	2.0	1.5
EV/Seat	0.47	0.34	0.22	0.15	0.11

Source: Company, ASK Raymond James. Note: Valuations as of 3 April 2007.

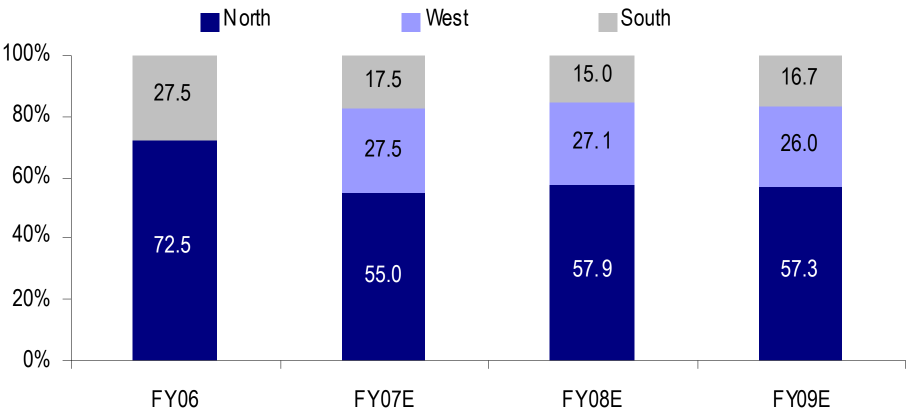
Investment highlights

PVR Cinemas is one of the leading cinema chain operators in the country and presently operates around 80 screens spread all over India barring the eastern belt. The company has very aggressive expansion plans of more than 110 screens over next two years with a seating capacity of around 52,000 seats at the end of FY09E. Apart from wider geographical reach of theatrical presence for the cinemagoers, the company is also entering the film production business through its 100% subsidiary PVR Pictures by tying up with Aamir Khan Production. Considering the company's aggressive expansion plans and increasing consumer spend on film entertainment, we expect the revenues of PVR to grow at a CAGR of 58% (FY07-FY09E) to Rs4.03 bn and EPS to be at Rs8 for FY08E and Rs14.5 for FY09E.

Multiplexing in growing northern India

Dominant player in the northern belt.

Exhibit 2: Growing screen presence in lucrative markets



Source: Company, ASK Raymond James.

Exhibit 3: Performance in the northern region (Nos)

	FY05	FY06	FY07E
Screens	25	37	44
Footfalls per day per screen	436	492	694
% growth		12.8	41.1

Source: Company, ASK Raymond James

- **35-40% market share in terms of screen:** PVR is a dominant exhibition player especially in the North with approximately 35-40% of market share in terms of screens in the northern region. The company presently operates around 44 screens out of the total 80 screens in the northern belt out of which Delhi alone has a total strength of 14 screens.

  Over and above its strong screen presence, PVR is quite a prominent brand in the North, which makes it a premium and preferred multiplex operator. PVR would be further leveraging on its brand by further penetrating in the Delhi market. The company has been doing very well in the northern zone and has managed to garner high number of footfalls from all its properties from this zone. (For detailed information on property-wise footfalls refer page 15).

Expansion plans to run 192 screens with a capacity of around 52,000 seats by FY09E.

Aggressive growth strategy - Pan India

- **Aiming to become the largest cinema player:** In the initial phase, PVR expanded in North of India and now plans to expand pan India. The company is expanding its reach down South and has already made its presence felt in the western region by commencing multiplex operations in Mumbai and Aurangabad. Going forward, the company would concentrate more on the northern and western belt for its expansion plans. PVR is adopting a very aggressive growth strategy to become the largest Cinema Player in the country and has expansion plans to setup over 110 additional screens over next two years. The aggressive growth strategy adopted by the company would help them leverage their position in the film exhibition business to negotiate with the film distributors for better share of revenues and compete with existing players. It would also help the company in locking prominent malls in every location (city).

PVR leads in terms of future screen strength.

Exhibit 4: Total screens of multiplex players (Nos)

	FY06	FY07E	FY08E	FY09E
PVR	51	80	140	192
Adlabs Films	31	74	122	170
INOX	35	73	108	164
Shringar	22	45	99	148
Cinemax	29	44	94	141

Source: Respective company data, ASK Raymond James.

PVR leads the chart in terms of expansion plans compared to its close competitors in the film exhibition business and expects to operate 192 screens with around 52,000 seats by FY09E. The company manages an average of four screens on each of their multiplex property and an average of 270 seats per screen (see Exhibit 4).

PVR currently operates with 80 screens having a seating capacity of 21,570 seats. The company expects to run 140 screens with 36,130 seats by FY08 and 192 screens with 51,828 seats by FY09 across the country (see Exhibit 5).

Exhibit 5: Future properties of PVR (Nos)

	FY08E				FY09E			
	Property	Screens	Seats	ET Exmt	Property	Screens	Seats	ET Exmt
Delhi	2	9	2,055					
Mumbai	2	13	3,400	Yes	1	4	1,250	Yes
Punjab	3	14	3,238	Yes	4	16	4,775	Yes*
Haryana	2	10	2,300					
Gujrat	1	3	1,094		1	4	1,400	
Tamil Nadu	1	7	1,600		1	6	2,033	
Uttar Pradesh	1	4	873	Yes	2	7	2,047	Yes
Rajasthan					1	4	1,193	Yes
Karnataka					1	5	1,500	
Dehradun					1	6	1,500	Yes
Total	**12**	**60**	**14,560**		**12**	**52**	**15,698**	
Cumulative	**33**	**140**	**36,130**		**45**	**192**	**51,828**	

Source: Company, ASK Raymond James
*Note: *ET exemption on 2 properties at Bhatinda and Amritsar out of 4*

Revenues to grow at a CAGR of 58% (FY07-FY09E)

Vast expansion plans and increasing number of film releases would enhance the revenues of PVR.

- **Vast expansion plans to boost revenues:** The Indian film industry (largest in the world in terms of number of films) is expected to grow at a CAGR of 18% over the next five years. We expect the revenue of PVR to grow at a CAGR of 58% (FY07-FY09E) to Rs4.03 bn in FY09E on the back of vast expansion plans by the company coupled with high appetite for film entertainment among the consumers. As per FICCI Report 2007, the domestic box office market is expected to grow at a CAGR of 13% (2006-2011) to Rs119 bn in 2011. The company's foray into the production business by tying up with Aamir Khan Production would also be EPS accretive and we expect the production business of PVR to add around Rs1 and Rs1.4 to its EPS in FY08E and FY09E respectively.

EBITDA margin to improve going forward

More properties under 100% ET Exempt and owned property at Mumbai would enhance margin.

- **Margins to improve to 18.1% in FY09E:** We expect the EBITDA margin of PVR to improve by 230 bps to 16.6% in FY08E and 150 bps to 18.1% in FY09E on YoY basis. The two major attributes for the margin improvement are: 1) Ownership model of seven screen multiplex in Lower Parel, Mumbai which is expected to commence operation by June 2007 with a capacity of 1,800 seats. We expect EBITDA margin of around 31%-32% from this property. 2) Out of the total incremental properties in FY08E and FY09E, approximately 52% and 54% of the total incremental seats are under 100% Entertainment Tax (ET) exempt (see Exhibit 6).

Exhibit 6: ET exempt properties **(Nos)**

	FY06	FY07E	FY08E	FY09E
Total seats	12,398	21,570	36,130	51,828
Incremental seats		9,172	14,560	15,698
ET exempted properties	1	7	13	20
Incremental ET exempted properties		6	6	7
ET exempted screens	3	29	60	90
Incremental ET exempted screens		26	31	30
ET exempted seats	726	8,095	15,606	24,121
Incremental ET exempted seats		7,369	7,511	8,515
% of ET exempt seats to total incremental seats		80.3	51.6	54.2

Source: Company, ASK Raymond James

Burden of Entertain Tax to go down in the future.

- **Entertainment Tax exemption:** PVR has been paying Entertainment Tax of around 25% of gross ticket revenues in the past three years. As per the future roll out plans, the company would operate 13 properties by FY08E and 20 properties by FY09E under 100% ET exemption, which would significantly reduce the entertainment tax burden for PVR. Further, with more and more states under the ET exempt scheme EBITDA margin is likely to improve on YoY basis, reflecting in better earnings for the company. For existing properties of PVR under 100% ET exempt (see Exhibit 7).

Exhibit 7: Existing properties under 100% ET Exemption

Property	Period
EDM, UP	Till mid 2009
Treasure Island, Indore	Till March 2011
Sahara Mall, Lucknow	Till March 2011
Juhu, Mumbai	Till mid 2012
Nirmal Lifestyle, Mumbai	Till August 2011
PVR, Aurangabad	Till December 2011
PVR, Latur	Till December 2011

Source: Company, ASK Raymond James.

Foray into the content production business

Investment of Rs200 mn for two films scheduled to be released in FY08.

- **Tied up with Aamir Khan production:** PVR intends to foray into content production business for big screen through their distribution arm - PVR Pictures and has signed up with Aamir Khan Production for co-production work of two films titled Taare Zameen Par and Jaane Tu Ya Jaane Na. The two films are expected to hit the theaters in mid FY08 with PVR's contribution of approximately Rs200 mn for both the films. Besides earning interest on the investment, PVR Pictures would also earn distributors commission and hold rights for the two films by sharing profit over a long period of time. We expect the production business to do well as PVR has partnered with Aamir Khan who has many hit films to his credit and is reputed for his discipline, hard work and quality.

Entry into tier I cities with low cost model

Launched low-frills digital cinema to capitalise in growing middle class of smaller cities.

- **ATP of Rs45-75, aims to increase reach in smaller towns:** The company recently launched low-frills digital cinema - PVR Talkies with an Average Ticket Price (ATP) of Rs45-75 and is aimed at increasing its reach to cover smaller towns. PVR presently operates low-cost cinemas at Latur and Aurangabad, which were launched in 3Q FY07 and has a capacity of 1,156 and 1,136 seats respectively with three screens each. The company would be able to manage the lower ticket prices as these locations have lower rentals and investment per seat would be around Rs40,000-45,000 per seat as compared to the multiplexes in cities having investment of Rs65,000-80,000 per seat. There is a growing middle class population in Tier I and Tier II cities, which is the target market for PVR. As there is no other good platform for entertainment in Tier I cities, cinema-going habit has seen an upward trend in the past one year. Although the condition being favorable for new cinemas theaters, the ticket prices in multiplex in smaller cities cannot be the same as that in the metros. Hence PVR has rightly positioned itself by going for a low frill model and operating at lower ATP.

Investment concerns

Fierce competition and location saturation

Intense competition from Adlabs Films, Inox, Shringar, Cinemax and other fragmented players.

- **Peers having greater financial resources:** The company faces intense competition with the existing players in the film exhibition business and some of them even have greater financial resources than PVR, which gives them a better-cost advantage to invest in Multiplex Cinema projects. As all the players are on an expansion mode, location saturation is bound to happen. This will in turn lead to decline in average occupancy for all the multiplex operators. The prominent competitor's for PVR are Adlabs Films, Inox Leisure, Cinemax, Shringar Cinemas (which are all listed companies) and other fragmented multiplex operators.

High dependence on quality film content

Dependent on the success of films.

- **Revenues could be affected if films fail to appeal the audience:** The film industry is heavily dependant on content supply and has been under pressure for quite some time now to produce good films that can generate maximum audience appeal with different taste and preference. If the film content produced in future fails to appeal to the audience, then PVR revenues would be affected. The failure of films would lead to lower occupancy levels and this would further lead to poor box office collection. We have seen a marked improvement in film content in 2005 and 2006 and expect the content to be appealing to the audience in future.

Delay in project execution

Any postponement or delay could affect the financial strength of PVR.

- **Over 110 additional screens over next two years:** PVR proposes to setup over 100 additional screens over the next two years, which involves huge capital cost and dependence on the mall developers. Any kind of delay in the scheduled implementation of the proposed projects for any reason, such as construction delays, delays in receipt of license or delays in delivery of equipment, could have an impact on the financial position and the future growth plans of the company. We expect the state government to be more efficient in terms of government related licenses and sanctions as the film exhibition industry not only provides an entertainment platform to the people but also provide employment opportunities. It would also add to the state ex-chequer on long term basis.

Valuations

Company on a high growth trajectory, increasing EBITDA margin, we however recommend Hold due to limited upside from current levels.

- **Hold with a target price of Rs203:** We expect the consolidated revenues to grow at a CAGR of 58% (FY07-FY09E) to Rs4.03 bn in FY09E. The growth is primarily driven by aggressive expansion plans in terms of screen strength; wider geographical presence and increasing consumer spend on film entertainment. As compared to other exhibition players, PVR enjoys a dominant position in the northern region with a prominent 'PVR' brand and is also widening its reach in the western and southern region. PVR is also making its maiden entry into the production business with Aamir Khan Production for two films scheduled for a release in the first half of FY08.

  We expect the EBITDA margin to improve by 230 bps YoY to 16.6% in FY08E and 150 bps YoY to 18.1% in FY09E on back of higher number of future properties under 100% ET exemption and one property in Mumbai with seven screens being introduced on the ownership model.

  The stock trades at 21.7x FY08E earnings and 12x FY09E earnings and at a PEG of 0.23. On back of strong revenue growth and better EBITDA margin, we expect EPS to be at Rs8 for FY08E and Rs14.5 for FY09E and arrive at our target price of Rs203 (14x FY09E earnings). Although the company is on high growth trajectory and increasing EBITDA margin, we recommend Hold on the stock as there is limited upside from current levels.

  We assign exit multiple of 14x FY09E earnings for PVR Cinemas to reflect:

  (i) Strong growth in earnings (93% CAGR FY07E - FY09E) over the next two years.

  (ii) Growing screen presence in lucrative markets of North and West (83% of total screens in these regions in FY09E from 73% in FY06)

  (iii) Will continue to retain dominant position in exhibition business despite aggressive expansion plans by competitors.

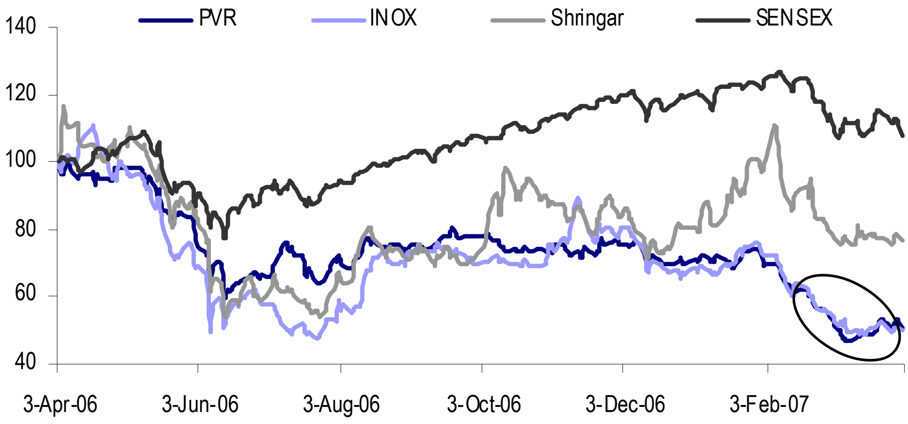
  (iv) Existing properties have good location in various cities and future properties are also expected to be situated at strategic locations in various cities.

Exhibit 8: Peer comparison

	FY07E		FY08E		FY09E	
Company	EPS (Rs)	PE (x)	EPS (Rs)	PE (x)	EPS (Rs)	PE (x)
PVR	3.9	44.6	8	22	14.5	12.0
INOX	4.5	24.4	7.9	14	13.4	8.2
Shringar	2.8	17.9	4.5	11	7.9	6.3

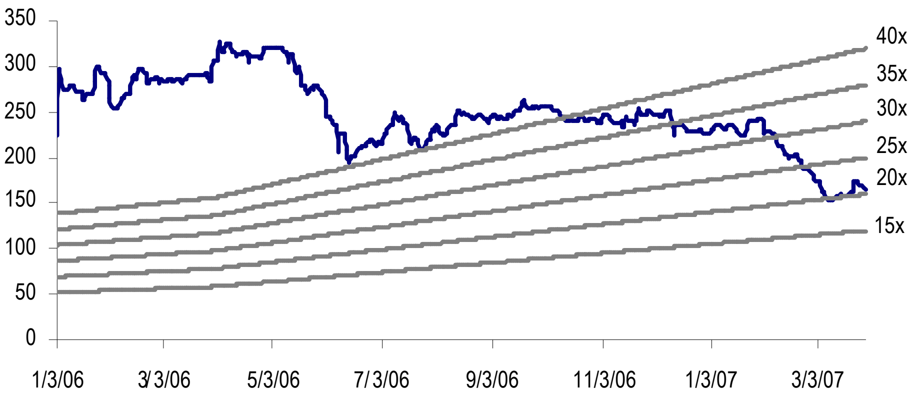
Source: Bloomberg, ASK Raymond James.

Exhibit 9: Yearly price movement



Source: Capital Line, ASK Raymond James.

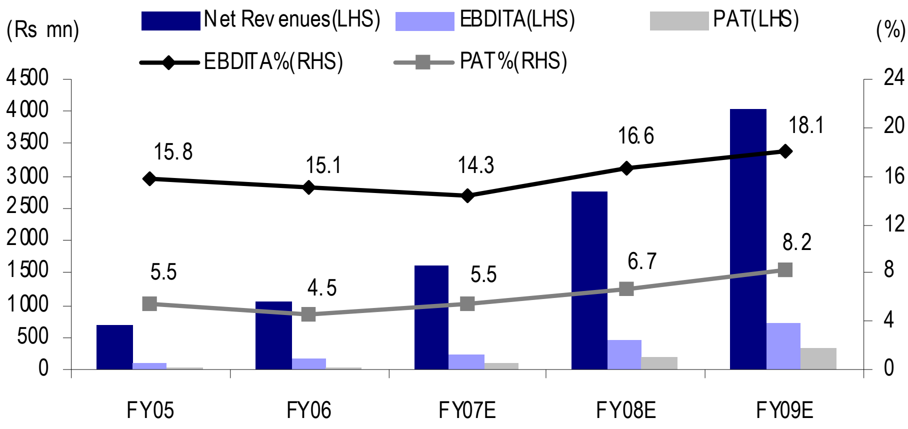
Exhibit 10: Rolling 1-year forward PE band chart



Source: Bloomberg, ASK Raymond James.

Financial Analysis

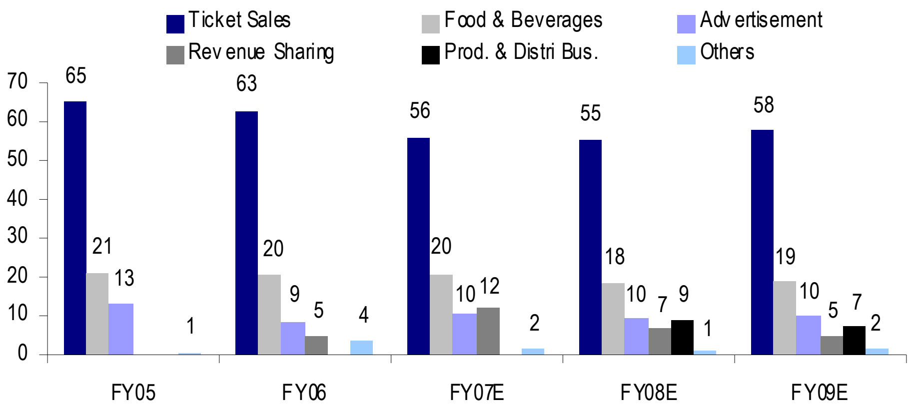
Exhibit 11: Financial performance



Source: Company, ASK Raymond James.

- We expect total net revenues to grow at a CAGR of 58% (FY07-FY09E) to Rs4.03 bn on back of vast expansion plans, wider geographical reach and its dominant position in the northern region (35-40% market share). EBITDA margin is expected to improve to 16.6% in FY08E and 18.1% in FY09E. This is primarily due to ~52% and 54% of the total incremental seats coming under 100% Entertainment Tax in FY08E and FY09E respectively and one property in Lower Parel, Mumbai with seven screens being introduced under the ownership model.

Exhibit 12: Revenue break-up as % of total net revenues



Source: Company, ASK Raymond James.

- The % contribution from ticket sales of total net revenues would marginally decline going forward as there would be a 9 % and 7% contribution from PVR's production and distribution business in FY08 and FY09 respectively.

Financials (Consolidated)

Profit & Loss statement (Rs mn)

Y/E March	FY05	FY06	FY07E	FY08E	FY09E
Net Ticket Sales	446	656	903	1,514	2,344
Food & Beverage	143	213	329	507	760
Advertisment	89	90	168	264	395
Revenue Sharing	0	49	192	184	186
Production	0	0	0	240	280
Others	5	41	28	39	68
Total Net Revenues	**683**	**1,049**	**1,619**	**2,747**	**4,032**
Distributors cost	177	268	438	718	1,075
Food & Beverage Cost	46	71	112	162	228
Employee Cost	74	133	198	279	392
Production Cost	0	0	0	200	230
Operating & Other Exp	278	419	640	931	1379
Total Expenses	**575**	**890**	**1,387**	**2,290**	**3,303**
EBITDA	**108**	**159**	**232**	**457**	**729**
EBITDA (%)	**15.8**	**15.1**	**14.3**	**16.6**	**18.1**
Depreciation	55	83	127	178	219
Interest	24	31	55	106	151
Other Income	24	43	86	100	135
PBT	**53**	**88**	**136**	**273**	**494**
Taxes	16	35	41	81	147
PAT	**37**	**53**	**94**	**191**	**347**
Less:Preference Dividend	0	5	5	8	15
PAT for shareholders	**37**	**48**	**89**	**183**	**332**
EPS (Rs)	**1.6**	**2.1**	**3.9**	**8.0**	**14.5**

Source: Company,ASK Raymond James.

Balance sheet (Rs mn)

Y/E March	FY05	FY06	FY07E	FY08E	FY09E
Equity Capital	171	229	229	229	229
ESOP	0	3	3	3	3
Preference Share Capital	0	200	200	200	200
Reserves & Surplus	362	1,495	1,532	1,647	1,882
Total Shareholders Fund	**533**	**1,927**	**1,963**	**2,078**	**2,314**
Secured Loans	455	614	614	1,414	2,014
Unsecured Loans	13	2	2	2	2
Total Loans	**468**	**616**	**616**	**1,416**	**2,016**
Deferred Tax Liability	42	46	50	50	50
Sources of Funds	**1,043**	**2,589**	**2,629**	**3,544**	**4,380**
Gross Fixed Assets	868	1,170	2,302	3,012	3,672
Less: Depreciation	160	228	355	533	752
Net Fixed Assets	**709**	**942**	**1,947**	**2,479**	**2,920**
Capital WIP	138	642	278	560	450
Intangible Assets	3	21	21	21	21
Investments	12	294	250	250	400
Current Assets	**333**	**999**	**602**	**954**	**1,537**
Inventory	7	9	15	25	40
Debtors	25	45	64	108	160
Cash/Bank	95	630	53	65	260
Loans and Advances	205	305	455	730	1,040
Other current assets	2	10	15	26	37
Less: Current Liabilities	**146**	**239**	**375**	**572**	**708**
Sundry Creditors	120	200	315	480	600
Income received in advance	20	32	50	80	95
Other current liabilities	5	7	10	12	13
Less: Provisions	11	72	94	147	240
Net Current Assets	**176**	**689**	**133**	**235**	**589**
Misc Expenditure	5	0	0	0	0
Application of Funds	**1,043**	**2,589**	**2,629**	**3,544**	**4,380**

Source: Company, ASK Raymond James

Cash Flow Statement (Rs mn)

Y/E March	FY05	FY06	FY07E	FY08E	FY09E
PBIT	77	118	190	379	645
Add: Depreciation	55	83	127	178	219
Less: Other Income	(24)	(43)	(86)	(100)	(135)
Less: Taxes	(2)	0	(35)	(36)	(73)
Inc/Dec in Working Capital	30	(37)	(43)	(142)	(250)
Others	39	30	(4)	(9)	(14)
Net Cash Flow from Operations	**175**	**152**	**149**	**269**	**392**
Change in Fixed Assets	(408)	(807)	(767)	(992)	(550)
Change in Investments	(7)	(282)	44	0	(150)
Other Income	24	43	86	100	135
Others	(25)	(31)	(4)	(9)	(14)
Net Cash Flow from Investing	**(416)**	**(1,077)**	**(641)**	**(901)**	**(579)**
Free Cash Flow	(241)	(937)	(573)	(723)	(308)
Proceeds from issue of Sh Cap	184	1,170	0	0	0
Change in borrowings	166	348	0	800	600
Dividend Paid	0	9	(25)	(42)	(52)
Interest Paid	(24)	(31)	(55)	(106)	(151)
Others	(16)	(37)	(5)	(9)	(15)
Net Cash Flow from Financing	**310**	**1,460**	**(85)**	**643**	**382**
Net Cash Flow	69	535	(577)	12	195
Add: Opening Cash	26	95	630	53	65
Closing Cash Balance	**95**	**630**	**53**	**65**	**260**

Source: Company,ASK Raymond James.

Key Ratios

Y/E March	FY05	FY06	FY07E	FY08E	FY09E
Growth (%)					
Revenues	39.4	53.6	54.3	69.7	46.8
EBITDA	49.1	47.1	46.2	96.9	59.7
PAT	144.8	27.3	87.4	105.3	80.9
Valuation (x)					
PER	106.4	83.5	44.6	21.7	12.0
P/BV	5.6	2.3	2.3	2.1	1.9
EV/EBITDA	40.4	26.3	20.5	12.1	8.1
EV/Net Sales	6.4	4.0	2.9	2.0	1.5
Profitablity (%)					
PAT margin	5.5	4.5	5.5	6.7	8.2
EBITDA margin	15.8	15.1	14.3	16.6	18.1
ROE	8.9	4.2	5.1	10.1	16.6
ROCE	6.5	4.3	4.1	9.2	13.0
Financial Ratios (x)					
Debt to Equity	0.9	0.3	0.3	0.7	0.9
Interest Cover	2.2	2.5	1.9	2.6	3.4
Current Ratio	2.3	4.2	1.6	1.7	2.2

Source: Company,ASK Raymond James.

Annexure I

Company background

- Incorporated in April 1995 pursuant to a joint venture agreement between Priya Exhibitors and Village Roadshow, PVR Cinemas under the leadership of Mr. Ajay Bijlee is now one of the largest cinema exhibition players with around 80 screens having a seating capacity of over 21,500 seats spread across the country.
- PVR is a pioneer and a trailblazer multiplex operator with experience of more than a decade in film exhibition business and also was the first company in India to have an international film exhibition operator - Village Roadshow as a strategic investor.
- The company made its entry into the capital market with a public issue of 77 lakh equity shares of Rs10 each in a price band of Rs200-240, in January 2006 to finance new cinema projects, expand film distribution business, technological upgradation and renovation of cinemas. The company got listed on 4 January 2006 and the discovered price was Rs240.
- PVR is adopting a very aggressive growth strategy to maintain their supreme position in the film exhibition business. The company plans to expand their screen strength to approximately 192 screens by FY09, which would help them continue to maintain their film exhibition standards and also compete with the existing players in this business.
- The company recently made their first move into low-frills digital cinema - PVR Talkies (Delhi) where the ATP ranges between Rs45-75. PVR also plans to start their content production business for big screen through their distribution arm - PVR Pictures.

Subsidiaries of PVR

- PVR Pictures (100% subsidiary) is involved in film distribution business, wherein it acquires and distributes Indian and international films and has also recently ventured into film production business by tying up with Aamir Khan Production.
- C.R. Retail Mall (100% subsidiary) is involved in the business of setting up multiplex cinema projects. It would operate the only owned property of PVR at Phoenix Mills, Lower Parel, Mumbai with seven screens and 1,800 seats, which is expected to commence operation by June 2007.

Business model

- PVR Cinemas is engaged into three business activities viz. film exhibition, film distribution and film production.

Exhibit 13: Film business profile of all listed players

Company	Exhibition	Distribution	Production	Post Production / Processing
Adlabs Films	✓	✓	✓	✓
PVR Cinemas	✓	✓	✓*	
Shringar Ciemans	✓	✓		
Inox Leisure	✓			
Cinemax	✓			

Source: ASK Raymond James.

*Note: *PVR is also entering into Film Production business. PVR Pictures (wholly owned subsidiary of PVR) has signed up with film star Aamir Khan who will be involved in co-production work with PVR.*

Film exhibition business

- PVR generated revenues of around 98% from its film exhibition business in FY06. The income generating channels in film exhibition business for PVR includes - revenue from Ticket Sales, revenue from food & beverages, advertisement revenue, revenue sharing income, royalty income and management fees.

PVR runs the film exhibition business into three different models

- **Rental model:** PVR presently operates 15 properties on rental basis and pays fixed rent per sq feet per month to the developer/owner of the respective multiplex properties. The company would operate all the future properties under rental model. The only property it owns is situated at Phoenix Mills, which is expected to commence operation by June 2007.

- **Revenue sharing model:** PVR operates four of its properties under the revenue sharing model with the developer/owner of the respective multiplex properties. These properties are Treasure Island, Indore (five screens, 1,140 seats), Nirmal Lifestyle, Mulund (six screens, 1,750 seats), Sahara Mall, Lucknow (four screens, 874 seats) and EDM Ghaziabad (three screens, 726 seats). Under this model, the revenue from ticket sales at these cinemas is accounted for on the basis of revenue share with the developer.

- **Management fees model:** Revenue from management fees is variable in nature and is calculated as a certain % of revenue made from the properties under this model. Two properties of PVR operate under the management fees model namely - Spice at Noida (eight screens, 1,821 seats) and SRS Mall at Faridabad (three screens, 776 seats).

Film distribution business

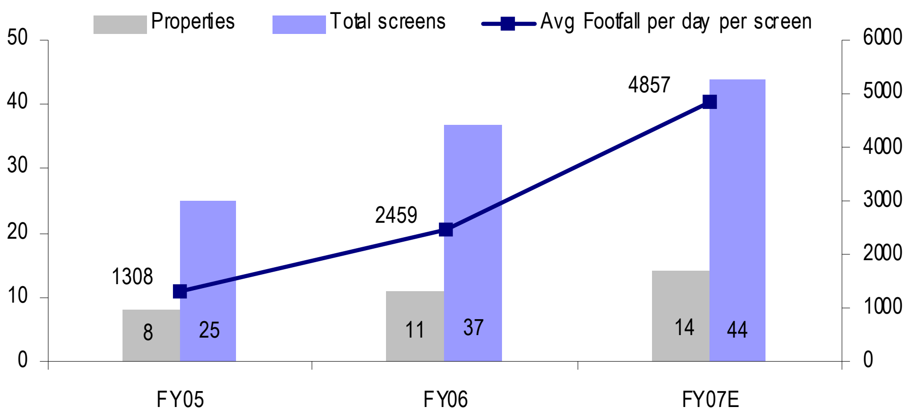
- PVR Cinemas is also involved in film distribution business and operates through its 100% subsidiary company PVR Pictures that was acquired in April 2005. The strategy adopted by PVR Pictures is to continue their activity on distribution of Hindi films in the territories where cinemas are located, and then purchase the entire suite of distribution rights including the theatrical, satellite/television and DVD rights for international films on an all India basis. Some of the recent movies distributed by PVR include Don and Omkara in few distribution territories.

Film production business

- PVR Pictures (distribution arm of PVR Cinemas) proposes to launch content production business for big screens and have entered into an agreement with Aamir Khan Productions for production of two movies namely Taare Zameen Par and Jaane tu ya Jaane Na. PVR Pictures would distribute the two movies produced by the joint venture of PVR Pictures and Aamir Khan Productions across India on a fee-based income model and also share approximately 20% of net profit arising from distribution of such movies. They will also act as co-producers of movies having fixed investment at minimal rate of interest. The two movies are expected to release by mid FY08.

Zone-wise performance of PVR

Exhibit 14: Performance in North (Nos)



Source: Company, ASK Raymond James.

Exhibit 15: Properties commenced operations in FY06

Property	Commencement Date
Spice, Noida	Dec-05
Central Mall, Hyderabad	Feb-06
Rivoli, Delhi	Feb-06

Source: Company, ASK Raymond James

Exhibit 16: Properties commenced operations in FY07

Property	Commencement Date
Juhu, Mumbai (3 screens)	Apr-06
Treasure, Indore	Apr-06
Sahara, Lucknow	Apr-06
Nirmal Lifestyle, Mumbai	Jun-06
Sahara, Gurgoan	Jul-06
Aurangabad	Oct-06
Latur	Oct-06
Aligarh	Oct-06
Juhu,Mumbai (Bal 2screens)	Feb-07

Source: Company, ASK Raymond James

Exhibit 17: Properties in North (Nos)

	FY05	FY06	FY07E
Delhi			
Screens	13	14	14
Footfalls per day per screen	665	705	743
Gurgoan			
Screens	7	7	9
Footfalls per day per screen	268	328	384
Faridabad			
Screens	5	5	5
Footfalls per day per screen	376	455	646
Ghaziabad			
Screens	-	3	3
Footfalls per day per screen	-	601	629
Noida			
Screens	-	8	8
Footfalls per day per screen	-	371	542
Aligarh			
Screens	-	-	1
Footfalls per day per screen	-	-	1428
Lucknow			
Screens	-	-	4
Footfalls per day per screen	-	-	484

Source: ASK Raymond James.

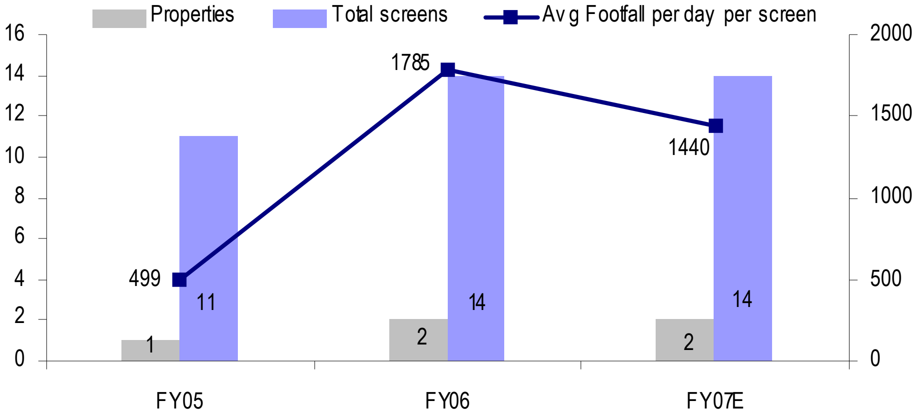
- Delhi region had maximum footfalls (3.4 mn in FY06) with an average occupancy rate of 44% and presently has 14 screens under operation with 4,324 seats. We expect the footfalls to grow to 3.8 mn in FY07.

- We expect the properties at Gurgoan and Faridabad to perform well in terms of footfalls and grow their footfall base from 0.8 mn each in FY06 to 1.2 mn each in FY07.

- Spice, Noida had footfalls of just 0.3 mn in FY06 as it was operational for around four months. We expect average occupancy of 47% from this property and get around 1.6 mn footfalls in FY07.

- Aligarh property started in 3Q FY07 and operates with a capacity of 1,275 seats and we expect around 28% occupancy from this property, which would result in 0.2 mn of footfalls in FY07.

Exhibit 18: Performance in South **(Nos)**



Source: Company, ASK Raymond James.

Exhibit 19: Properties in South **(Nos)**

	FY05	FY06	FY07E
Banglore			
Screens	11	11	11
Footfalls per day per screen	499	652	609
Hyderabad			
Screens	-	3	3
Footfalls per day per screen	-	1133	831

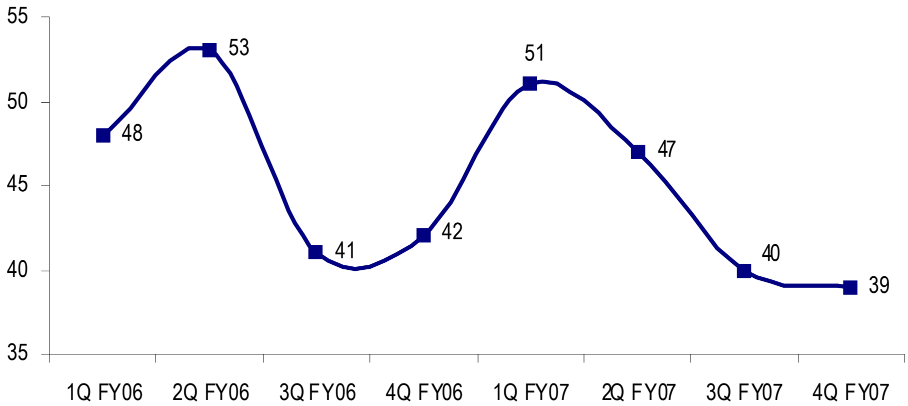
Source: Company, ASK Raymond James.

- The property at Bangalore stands in the second position after Delhi region in terms of footfalls, which was around 2.6 mn in FY06. (Bangalore property is the biggest multiplex compared to other properties of PVR and operates 11 screens with 2,011 seats).

- Hyderabad property operates with three screens and 926 seats and commenced operations in February 2006. The footfalls per day per screen were high in FY06 because the property was newly launched in that region. Going forward we expect footfalls of around 0.9 mn in FY07 and a substantial drop in footfalls per day per screen.

Average occupancy rate

Exhibit 20: Quaterly average occupancy (%)



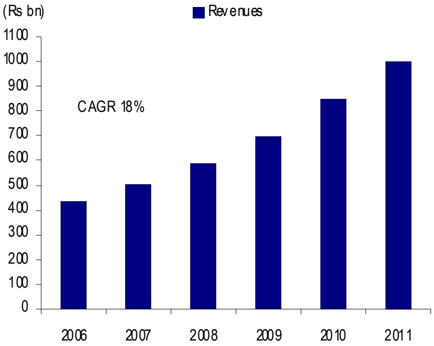
Source: Company, ASK Raymond James.

- The average occupancy rate dipped substantially in 3Q FY07 primarily because Dhoom 2 was not shown on any of the screens of PVR due to the on-going issue with Yash Raj Films and multiplex operators.
- We expect average occupancy in 4Q FY07E to further go down marginally to 39%, primarily due to dearth of any block buster film in 4Q FY07, ongoing World Cup tournament and academic year ending with examinations for schools and junior colleges.

Annexure II

Industry overview

Exhibit 21: Growth of Indian entertainment & media industry



Source: Industry Estimates & PWC Analysis.

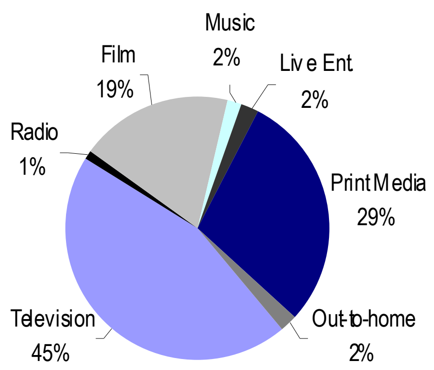
- **Media and entertainment industry - poised for take-off...:** The Indian Entertainment and Media Industry have out-performed the Indian economy and is one of the fastest growing sectors in India. It is rising on back of strong economic growth and rising income levels that India has been experiencing in the past years. Over the next 2-3 years, India is predicted to maintain the growth rate of little more than 8% and touch 10% by 2010.

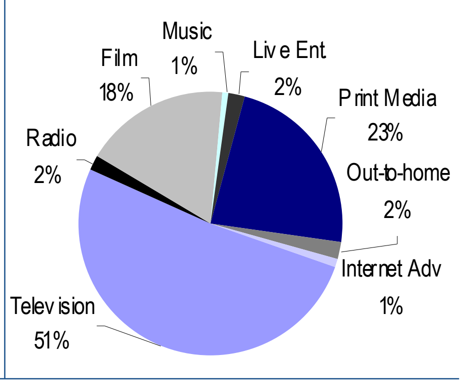
  The Entertainment & Media Industry in India is expected to grow at a CAGR of 18% (2006-2011) and reach over Rs 1 trillion by 2010.

  When incomes rise, proportionately more resources get spent on leisure and entertainment than on necessities. The consumption spending is rising due to increasing disposable incomes on account of sustained growth in income levels and reduction in personal income tax over the last decade. Higher consumption spending and consequent changes in lifestyle are also spurring the growth of the Indian Entertainment sector.

Exhibit 22: Components of Indian entertainment industry

2006 Revenue Rs436 bn	2011E Revenue Rs1,002 bn





Source: Industry Estimates & PWC Analysis.

  - The television industry continues to dominate in the E&M industry by contributing around 45% in 2006 and is expected to increase its share of the total pie to reach to about 51% in 2011.
  - The share of the film industry is expected to remain stagnant over the next five years in the range of 18-19%.
  - Print media that currently contributes 29% is projected to lose some of its share in favour of the emerging segments.

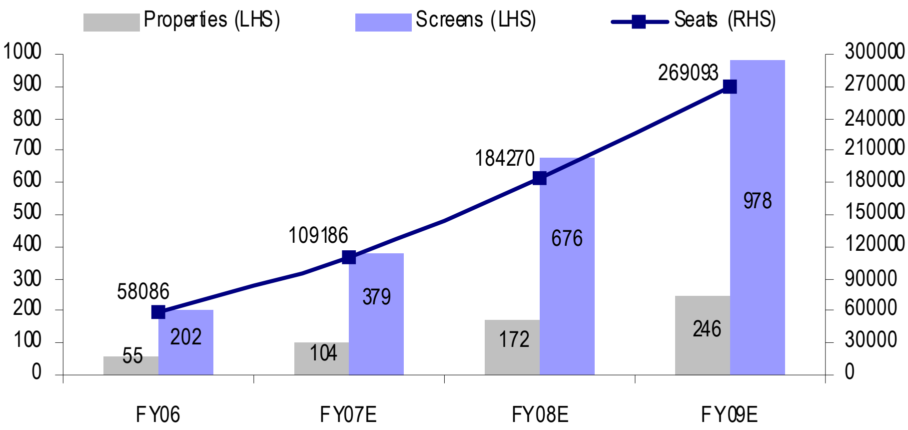
- Though films contribute just 19% to the entertainment & media revenues, they are the heart of this industry. Indian films, especially mainstream Hindi film industry, or Bollywood, dominate segments like music and live entertainment as well as television, where popular films and film-based programs attract the highest viewership.

- The film segment will ride on the growth of multiplexes and digital distribution formats. Better realizations in box office collections, growth in collections from the overseas markets as a result of better marketing and distribution set-ups and emergence of the home video market linked primarily with the purchasing power of the consumers, will drive the growth of the filmed entertainment in the next five years which is expected to grow at a CAGR of 16% (2006-2011)

Multiplex - Expanding film exhibition business

- The mantra of film exhibition business today is - multiplex. It emerged out of the necessity to cater to the busy, fast moving and variety-loving consumer who wants more than just one film under a single roof with better ambiance and good quality viewing experience.
- The multiplex model is based on the concept of umbrella entertainment built around a primary anchor - movies. However, the revenue also flows in from food & beverages, advertisement, promotions and other channels.
- The year 2005 has been very productive for multiplex segment of the film industry where in three of the largest film exhibition companies (Shringar Cinemas, PVR and INOX) went public and raised around Rs4.15 bn in 2005/early 2006.

Exhibit 23: Projected growth of multiplex **(Nos)**



Source: Industry, ASK Raymond James.

- In view of the aggressive growth plans by all the leading film exhibition companies, the number of multiplexes is expected to grow to approximately 246 properties in FY09 from 104 properties in FY07. The growth in the number of screens is expected to touch close to 978 screens with a capacity of around 2.7 lakh seats in FY09.

Advantages of multiplex format

- Multiplexes can show a new release on all 3-4 screens and thus increase the revenues in first three days itself.
- The offbeat and small budget films have started doing well at the box office because of the multiplex format.
- Ambience is very good when compared to the existing single screens.
- Having a multiplex ensures about 1,200 footfalls daily, which is great for a shopping mall.
- Based on expected potential audience, the multiplex operator can display a movie in an auditorium.
- Since there are 3-4 screens in a multiplex, the exhibitor has the flexibility to decide on the time and the number of screens to be utilized for a specific movie.

Growth drivers

Mall development in Tier I cities

- Mall development in Tier I cities would increase the number of multiplexes in the country as multiplex operators are anchor tenants for malls and go hand in hand with the other tenants of the mall to attract footfalls. This allows them to get access to potential target audience with high disposable income.

Entertainment tax benefit

- Entertainment tax benefit entices the multiplex operators to invest large sum of money in setting up the multiplexes. A multiplex operator improves its operating margin by availing the benefit of Entertainment Tax exemption, which varies from 30-100% of net ticket price from state to state.

Exhibit 24: Entertainment tax benefits

	Yr 1 (%)	Yr 2 (%)	Yr 3 (%)	Yr 4 (%)	Yr 5 (%)	Yr 6 & 7 (%)	Min Seats (Nos)	Min Screens (Nos)
Mumbai	100	100	100	75	50	-	1,250	4
Rest of Mh'tra	100	100	100	75	50	-	1,000	3
Punjab	100	100	100	100	100	-	1,000	3
West Bengal	100	100	100	100	-	-	1,000	3
Rajasthan	50	50	50	50	50	50	1,000	N.A
U.P.	100	100	100	100	100	-	1,000	3
M.P.	100	100	100	75	50	-	1,000	3
Karnataka	100	100	100	75	50	-	N.A	N.A

Source: Cinemax RHP, Company Data.

Consumer spending

- With the advent of multiplexes and availability of quality home entertainment software and hardware, there has been an increase in consumption of film entertainment by consumers in the age group of '15-34'. The Hindi film industry attracts 40-50% of total consumer spending on Indian film entertainment. Tamil and Telugu language markets are the other two important regional film industries in India.

Industry status

- Due to entertainment and media getting industry status, one can see an increasing number of players getting access to institutional finance. Almost all of the big players in the film exhibition industry have listed in the past two years. As they have gone public they now have access to various funding options.

Notes

Notes

Rating Structure

Our Equity Rating Structure is based on Absolute Valuations–based on a Discounted Cash-Flow (DCF) Model, though we also look at PE, EV/EBITDA and other related valuation metrics. Our implicit belief is that stock prices tend to approximate, at one time or another, their true value based on future cash flows, if these estimates materialize.

Our Rating Structure is based on the following levels of expected Absolute Returns:

Rating	Target Price (if the value exceeds the Current Market Price)
Buy	by more than 14%
Hold	by 6% to 14%
Sell	is below 6%

The Percentage Bands are based on the current Risk-free Rate (RFR) of 6% and the Equity Risk Premium of 8% which are empirically observed in India's Debt and Equity markets. Therefore, for a **'BUY'** recommendation on Indian equities, the minimum under-valuation or expected return in absolute terms must be greater than 14% to compensate for the market risk of equities. Similarly, we think that for a **'HOLD'** recommendation, the minimum under-valuation or expected return must be at least equivalent to the risk-free rate and, ideally, much higher. But if the expected return is below even the risk-free rate or if the stock is over-valued, implying a negative absolute return, then the stock under consideration is a clear **'SELL'.**

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