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Entertainment

Multiplex Magic

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The fastest growing lifestyle segment

The Indian lifestyle segment is headed for strong growth during the next few years, propelled by the dramatic changes in the lifestyle of the Indian consumer. Lifestyle categories that are associated with higher quality, taste, and aspiration, have put traditional spending on food, groceries, and clothing, on the back seat. This has led to a boom in organized retail which, in turn, has trickled down to the entertainment segment. Mall developers have responded to the latent need of the Indian consumer for a consolidated entertainment complex with an 'under one roof' positioning. Not surprisingly, the number of multiplexes across the country has increased significantly during the past few years. The growing share of entertainment expenditure in the disposable income pie is driving a revolution around India's favorite entertainment option today - Movies.

We believe that India's movie exhibition sector is poised for significant growth, going forward, due to:

- Changing lifestyle of Indian consumers
- Retail boom in India
- Rising disposable income levels
- Aggressive expansion plans of multiplex operators supported by availability of entertainment tax exemptions
- Strong growth prospects of the Indian film industry

The stocks in the movie exhibition sector seem to be expensive in relation to the market. However, given the strong potential for growth, we are positive on this sector. Therefore, we initiate coverage on the sector with a 'BUY' rating on the multiplex operators namely PVR Limited (PVR), Shringar Cinemas Limited (Shringar), and Adlabs Films Limited and a 'HOLD' rating on INOX Leisure Limited(Inox).

Companies	CMP	Reco.	Net Sales		EBITDA		PAT		EPS		PE	
			FY07E	FY08E	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E
Adlabs	373	Buy	2,249	3,456	783	1,303	649	904	16.3	22.7	22.9	16.4
Inox	183	Hold	1,746	2,346	597	788	310	444	5.2	7.4	35.4	24.7
PVR	234	Buy	1,827	3,456	362	803	122	303	5.3	13.2	43.9	17.7
Shringar	57	Buy	900	1,700	179	387.6	63	135	2.3	4.6	24.7	13.3

Investment Rationale

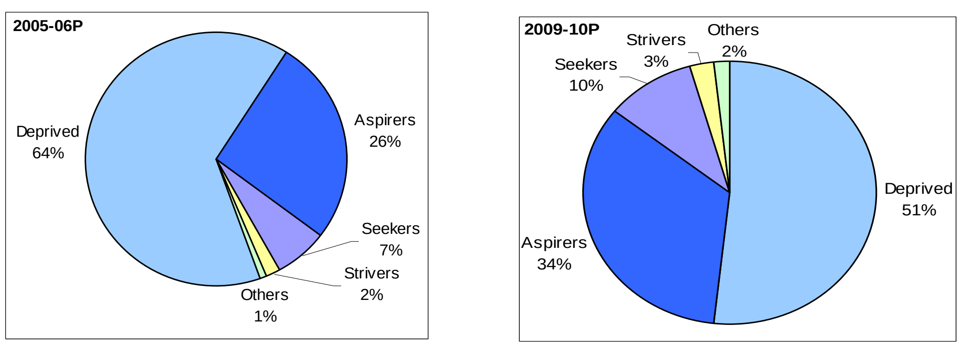
Industries such as organized retailing, media and entertainment, hospitality, and leisure are likely to see strong growth in the next few years.

- **Changing Lifestyle of Indians:** Most developing markets of the world have witnessed a dramatic change in consumer lifestyles after their economies have been liberalized. Similarly, after the Indian capital market opened up for overseas investors, a sea change in the lifestyles of the Indian consumers has already begun. We are now beginning to see the benefit of India's large population of over 1.07bn and its emergence as a growing powerhouse in the IT/ITES sectors. We believe that India is ready to leap into the fast-growing consumption boom. Industries such as organized retailing, airlines, apparel brands, media and entertainment, hospitality, and leisure, are likely to see a significant increase in revenues over the next decade.

During the past one decade, the salaries of the Indian middle class have increased by over 250%.

- **Rising disposable incomes:** The aspirations of India's middle class have now climbed to a different scale, thanks to the rising salary levels across this section of the society. In the last decade alone, the salaries of the Indian middle class have increased by over 250%, registering an annual CAGR of 11% (see chart 1). This staggering increase in income levels can be attributed to the rising demand for IT/ITES professionals in India. Rising disposable income of the urban Indian consumer has, in turn, led to a consumption boom. The country's changing demographics have also fuelled consumerism; with nearly 65% of the population under 35 years of age (in 2005), India is one of the youngest nations in the world.

Chart 1. India: Growing middle class



Source: IISL research, company

The number of shopping malls in India is likely to increase from 100 in 2005, to 358 by the end of 2007.

- **Retail boom in India:** Organized retail consumption increased from 1% of total retail consumption in 1999, to nearly 3% in 2004; this proportion is likely to increase to about 8%-10% over the next five years. The retail business in India is likely to register healthy growth in the next few years: by the end of 2007, the number of shopping malls is likely to increase from 100 to a staggering 358 with a total built up area of 87.8 mn square feet. Multiplexes, being one of the anchor tenants in large malls, contribute to about 40-50% footfalls. We expect

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this boom in organized retail to result in the success of multiplex cinemas and vice versa.

Organized players are now targeting Tier II and Tier III cities that offer strong growth potential for the movie exhibition industry.

- **Aggressive expansion plans of multiplex operators:** The organized players in the movie exhibition industry have laid out aggressive expansion plans to be executed during the next 2-3 years. Most of these players, including Shringar, Adlabs, and Inox, intend to expand their domestic presence by setting up multiplexes in Tier II and Tier III cities that offer strong growth prospects; until now, most of these players were focused on metros and Tier I cities. These expansion plans, if executed successfully, are likely to change the face of the multiplex industry. The organized retail boom in the country is likely to complement the growth of these multiplexes over the medium term.

Various state governments are offering entertainment tax exemptions to encourage the growth of multiplex cinemas and conversion of single-screen cinemas into multiplexes.

- **Entertainment tax exemptions:** Entertainment tax rates in India were one of the highest in the world and vary from 20% to 125% of gross box office collections. To encourage investments in this high-demand movie exhibition industry, various state governments have announced policies offering entertainment tax benefits. This has encouraged the growth of multiplex cinemas, while encouraging single-screen theatres to convert into multiplexes. We believe this would increase the profitability for multiplex owners and reduce their payback period.

Corporatization of the Indian film industry, increasing focus on the NRI population, and securing of overseas and satellite rights by film producers, are some of the factors that enhance the growth prospects of the Indian film industry.

- **Strong growth prospects of the Indian film industry:** The fortunes of the multiplex industry are linked to the performance of the Indian film industry. Over the years, movies have emerged as the most popular and affordable means of entertainment. Factors such as increasing focus on the growing NRI population and securing of lucrative overseas and satellite rights, are multiplying the revenues of film producers. Moreover, the entry of corporate entities in the production space has professionalized and corporatized the Indian film industry; some of these corporate entities include UTV, Yash Raj Films, and Sahara One. Given these indicators, we believe that the production of quality movies is likely to improve significantly, going forward. This, in turn, will augment the growth prospects of the Indian film industry.

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Valuation Comparison

Adlabs	Buy	Year-end	Sales	YoY	EBITDA	YoY	NP	YoY	EPS	YoY	PE	EV/EBITDA	PSR	PBR	RoE	RoCE	DPS	Div Yield
		March	(Rs m)	(%)	(Rs m)	(%)	(Rs m)	(%)	(Rs)	(%)	(x)	(x)	(x)	(x)	(%)	(%)	(Rs)	(%)
Price (Rs)	373	FY2005	957	-	407	-	194	-	10	-	38.8	10	16	3.2	16.5	22.5	7.6	2.0
Mkt cap (Rs m)	14,854	FY2006	1,213	27	435	7	281	45	7	-27	53.1	27	12	2.2	8.3	4.1	5.1	1.4
Mkt cap (mn USD)	323	FY2007E	2,249	85	783	80	649	131	16	132	22.9	15	7	1.9	16.6	7.0	5.1	1.4
Shares o/s (mn)	20	FY2008E	3,578	59	1,303	67	904	39	23	39	16.4	9	4	1.6	19.2	10.3	5.1	1.4

Inox	Buy	Year-end	Sales	YoY	EBITDA	YoY	NP	YoY	EPS	YoY	PE	EV/EBITDA	PSR	PBR	RoE	RoCE	DPS	Div Yield
		March	(Rs m)	(%)	(Rs m)	(%)	(Rs m)	(%)	(Rs)	(%)	(x)	(x)	(x)	(x)	(%)	(%)	(Rs)	(%)
Price (Rs)	183	FY2005	606	-	216	-	81	-	2	-	102	42	14	13.9	13.7	11.7	-	-
Mkt cap (Rs m)	10,962	FY2006	1,021	69	360	66	175	117	3	63	62	33	11	5.1	8.1	9.5	-	-
Mkt cap (mn USD)	238	FY2007E	1,746	71	597	66	310	77	5	77	35	20	6	4.4	12.6	15.3	-	-
Shares o/s (mn)	60	FY2008E	2,346	34	788	32	444	43	7	43	25	15	5	3.8	15.2	18.3	-	-

PVR	Buy	Year-end	Sales	YoY	EBITDA	YoY	NP	YoY	EPS	YoY	PE	EV/EBITDA	PSR	PBR	RoE	RoCE	DPS	Div Yield
		March	(Rs m)	(%)	(Rs m)	(%)	(Rs m)	(%)	(Rs)	(%)	(x)	(x)	(x)	(x)	(%)	(%)	(Rs)	(%)
Price (Rs)	234	FY2005	683	-	108	-	38	-	2	-	106	41	6	7.6	7.2	5.3	-	-
Mkt cap (Rs m)	5,362	FY2006	1,049	54	158	47	53	40	2	4	102	35	5	3.1	3.1	3.0	1.4	0.6
Mkt cap (mn USD)	117	FY2007E	1,827	74	362	128	122	132	5	132	44	17	3	3.0	6.7	8.4	1.6	0.7
Shares o/s (mn)	23	FY2008E	3,456	89	803	122	303	148	13	148	18	9	2	2.6	14.6	14.3	1.6	0.7

Shringar	Buy	Year-end	Sales	YoY	EBITDA	YoY	NP	YoY	EPS	YoY	PE	EV/EBITDA	PSR	PBR	RoE	RoCE	DPS	Div Yield
		March	(Rs m)	(%)	(Rs m)	(%)	(Rs m)	(%)	(Rs)	(%)	(x)	(x)	(x)	(x)	(%)	(%)	(Rs)	(%)
Price (Rs)	57	FY2005	379	-	34	-	-35	-	-	-	-38	51	4	7.5	(19.6)	(0.3)	-	-
Mkt cap (Rs m)	1,798	FY2006	580	53	53	57	-29	-	-	-60	-95	36	3	3.0	(3.2)	1.9	-	-
Mkt cap (mn USD)	39	FY2007E	900	55	179	237	63	316	2	-485	25	15	2	2.7	10.9	6.1	-	-
Shares o/s	32	FY2008E	1,700	89	388	117	135	115	5	99	13	7	1	2.2	17.9	12.1	-	-

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Changing Lifestyles Of Indian Consumers: Key Factors

- **Consumption trend:** The trend in aggregate consumer spending corroborates the consumption boom in the economy. Over the past five years, discretionary items (unlike basic necessities like food) have been growing at an average of 9 per cent per annum; the growth has been more significant during the past two years. Historically, a nation of savers, India has now become a nation of spenders.

Spending on entertainment, clothing, and dining has increased significantly during the past few years.

- **Consumption pattern in India:** The consumption pattern of Indian consumers is slowly converging with global norms. The Indian consumer is now spending more on consumer durables, apparels, entertainment, vacations, and lifestyle-related activities. Categories such as entertainment, clothing, and dining, have noted the maximum rise in consumer spending since 2002. In line with global trends and with the rise in domestic income levels, the share spent on food and grocery in the total household income has declined proportionately (*Source:IBEF*), whereas the proportion of income spent on lifestyle-related activities has increased.

- **Increasing purchasing power:** We believe that the emergence of the Indian middle class with greater earning power and a higher disposable income is one of the key factors that will drive the growth of multiplex cinemas, going forward. Table 1 indicates the growth in the number of middle and high-income households in India.

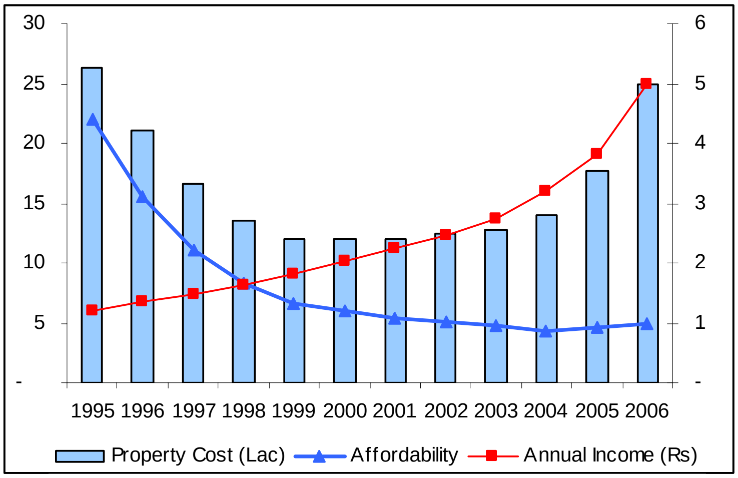
Table 1. Increase in middle income household in India

mn	1995-96		2001-2002		FY09 (E)	
	No.of households	Population	No.of households	Population	No.of households	Population
Rich > Rs 0.5	1.2	7	2.6	15	7	40
Upper middle Rs 0.3 - 0.5	33	186	46	265	91	525
Middle Income Rs 0.1-0.3	54	312	74	429	85	490
Lower Income < Rs0.1	77	444	57	332	30	177

Source: ICICI Bank

As depicted in the Table 1, 56mn households, with a population of 320 million people, will be added in the middle-income group between 2003 and 2009. Chart 2 depicts the rising affordability of the consuming class (as computed by HDFC) for an average family residing in suburban Mumbai. The affordability (cost of property divided by the annual income) has come down drastically, from 22 times to 5 between 1995 and 2006.

Chart 2. Rising affordability of Indian consuming class



Source: HDFC

The number of people in the working age population of 15-59 years is likely to jump from 700mn in 2006 to 800mn in 2011.

- **Changing demographics:** About 65% of the Indian population is below 35 years of age and more than 50% of population is below 25 years of age (median age – 24 years). The urban population in the age band of 15-34 is expected to grow at 30%, from 107mn in 2001 to 138mn in 2011. The urban population in the age group of 15-44 years is expected to increase from 146mn to 186 mn during the same period, registering a 27% increase (*Source: Yes bank*). The number of people in the working age population of 15-59 years is set to jump from 700mn in FY06 to 800mn by 2011. Between 2003 and 2009, 130 mn people are expected to be added to the working population (*Source: ICICI Bank*). We believe that this expected increase in urban population and the lowest median age, should boost the lifestyle segment in India.

The number of credit/debit cards issued in India has increased to 44mn in 2004 from 3mn in 1998.

- **Change in the mode of spending:** The increased usage of credit cards is an indication of the increasing spends of the Indian consumer; this is because rather than parting with hard cash, consumers prefer using credit cards for large payments. Moreover, consumers are increasingly getting comfortable with the usage of credit cards, given the growing awareness and application of IT and IT products in day-to-day activities. In our estimate, maximum users of credit cards fall in the age group of 22-45. The increase in the number of people in this age group is likely to be the strength of the Indian economy and the consumption pattern, going forward.

  The total number of cards issued has increased from three mn in 1998 to 44 mn credit/debit cards in 2004. Nevertheless, the total spend in India on cards is still less than 1% of the country's personal consumption expenditure. Most spend in credit cards are made in the gasoline category. During the past two years, the spending on hotels and lodging has increased from 16% to 19% (see charts 3). Moreover, the average spend per card has increased substantially across all the major cities in India.

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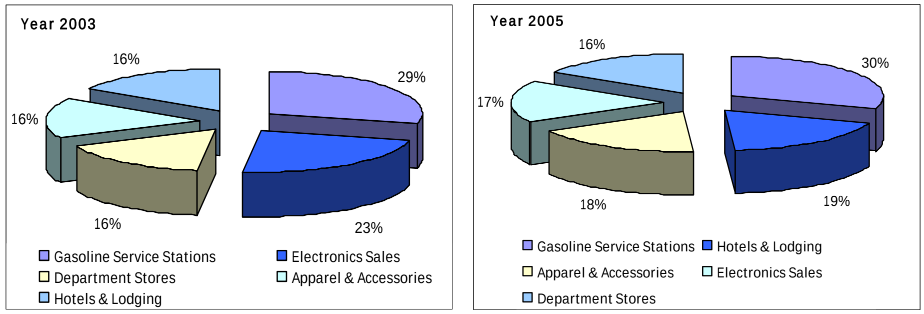
Chart 3: Top spending categories through credit cards

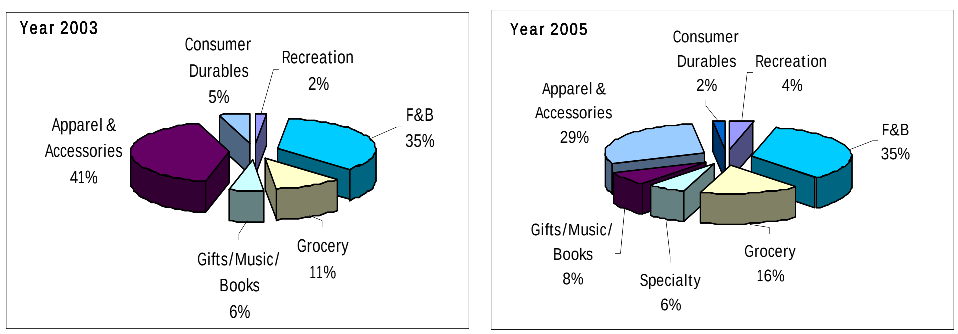


Source: Malls in India by IMAGES

During the past two years, the consumer spend on recreation and entertainment activities across major cities of India has increased significantly.

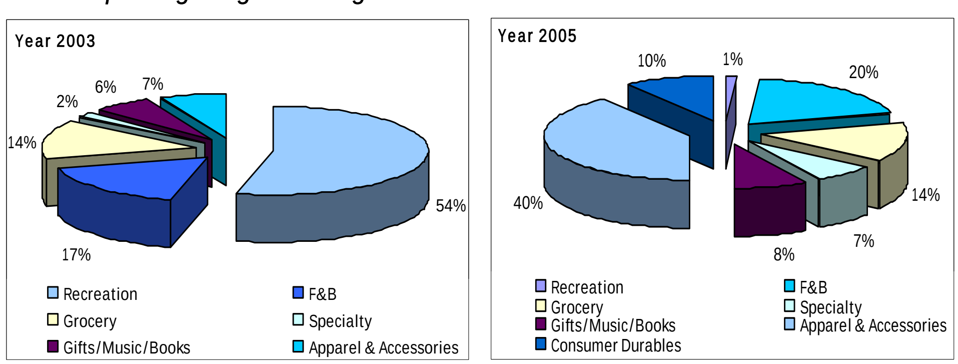
The analysis on consumer spending in top six metros individually, where multiplex companies are expanding their operations, reveals that apart from the increased spending on regular categories, consumers have increased or started spending on recreation or entertainment activities. The spending categories have been classified as: Apparel and accessories, consumer durables, F&B, gift items/music/books, monthly provisions/grocery, recreation, and specialty (home decoration, health and hygiene). In Mumbai, recreation accounted for 4% of total consumer spending in FY05, up from 2% in FY03(see chart 4); for Bangalore, this proportion increased from nil to 1% during the same period (see chart 5).

Chart 4: Spending categories - Mumbai



Source: Malls in India by IMAGES

Chart 5: Spending categories -Bangalore



Source: Malls in India by IMAGES

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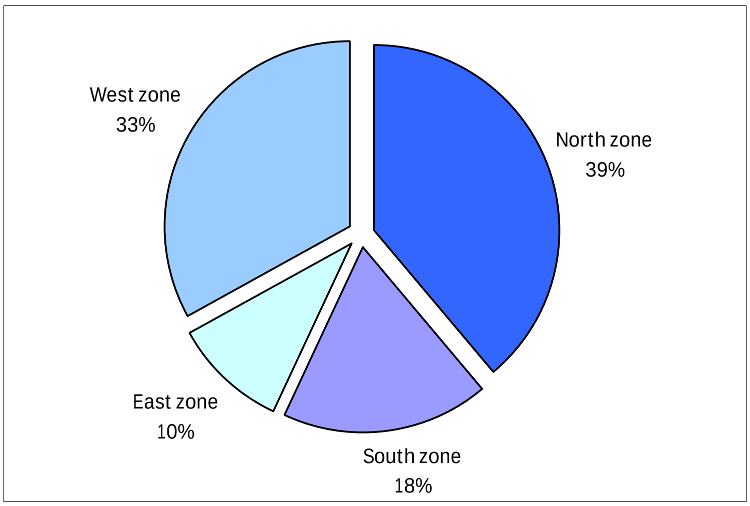
Organized retail consumption increased from 1% of total retail consumption in 1999 to nearly 3% in 2004.

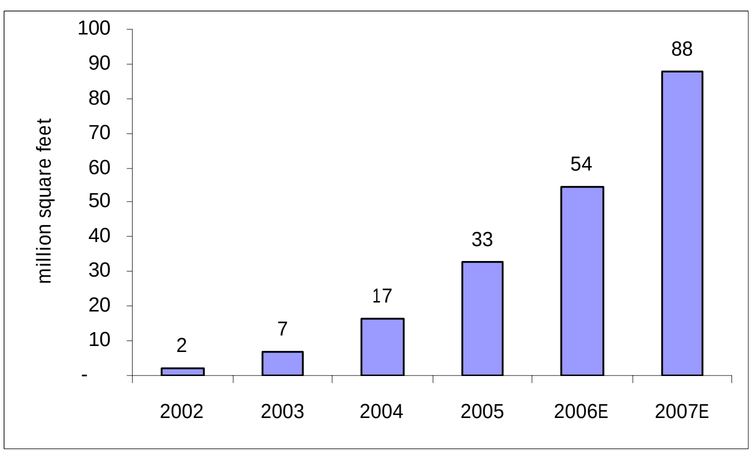
- **Organized retail boom:** Over the past few years, the growth in the Indian retail sector has been driven by the country's economic fundamentals; these include increase in the proportion of upper income household, rising consumption expenditure, and greater use of credit cards. Organized retail consumption increased from 1% of total retail consumption in 1999 to nearly 3% in 2004; this proportion is likely to increase to about 8%-10% over the next five years. The retail business in India is likely to register healthy growth in the next few years: by the end of 2007, the number of shopping malls is likely to increase from 100 to a staggering 358, with a total built up area of 87.8 mn square feet (chart 7). Currently, the National Capital Region (NCR) and Mumbai account for maximum numbers of shopping centers in the country. Chart 6 shows the distribution of mall space across India. One of the key elements for the success of the mall is its ability to drive footfalls consistently.

Chart 6. *Distribution of mall space developments across Zones: 2007*



Source: Malls in India by IMAGES

Chart 7. *Mall Space in India*



Source: Malls in India by IMAGES

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Multiplex Industry –In Expansion Mode

During the next two years, the multiplex industry is expected to invest more than Rs1,200 crore. The growing share of entertainment expenditure in the disposable income pie is driving a revolution around India's favourite entertainment option today - Movies.

Multiplex cinemas have an average of 250 seats per screen and are often characterized by a good ambience, comfortable seating, air conditioning, modern infrastructure, and good quality F&B.

Key growth drivers for multiplexes:

There are several external and internal factors influencing the growth of multiplexes:

External factors

- **Increasing corporatization of film production:** Corporatization increases the number of high quality films produced; this in turn, increases demand for movies. In such a corporate environment, unviable movies with weak scripts find it difficult to garner funding. According to CII-KPMG, the average number of films produced annually in India is expected to fall from over 900 in 2004 to around 600 by 2010; this implies that the quality of the movies produced is expected to increase. We believe that this trend would, in turn, increase the occupancy levels in multiplexes and contribute to higher revenues.

Crossover films, showcasing India in an urban context, are entertaining over 15mn Indian diaspora across the globe.

- **Higher crossover films:** India has the potential for creating a global product, i.e. films showcasing an Indian theme in an urbane context. Such films have immense international appeal, entertaining over 15 mn Indian diaspora, with a significant spending power, across the world. The return on investment is good because the cost of producing such type of films in India is much lower than the revenues generated by these films on a global platform. Further, the cost of producing Bollywood films is relatively low - anywhere from US$ 1 mn to US$ 4 mn; in Hollywood a US$ 20 mn production is considered low budget. These crossover films are likely to result in mainstream Indian films finding a wider global audience, increasing the industry's revenue potential.

Regional movies are now dubbed/sub-titled in Hindi and English, increasing their viewership base across the country.

- **Increasing regional cinemas:** According to industry estimates, Hindi films command a 40 per cent share of the Indian film market today; a large portion of the films made in India are produced in the south and east regions of India in regional languages. The earlier trend of confinement of viewership of regional films in local areas is changing. Such films have international viewership catering to the demands of regional base of Indians across the globe. Even within India, their demand is rising, as these are being dubbed/sub-titled in Hindi/English. For the regional producer, this results in increased scalability in terms of content and access to new geographies. For the investors/producers, it means de-risking their investment base by widening the audience portfolio.

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The dubbing of Hollywood movies in Hindi has increased admissions in Indian theatres.

- **International cinema dubbed in Indian languages:** India is witnessing a splurge of international films, specifically Hollywood movies being dubbed in local Indian languages and being screened in the Indian cinemas. This has increased admissions in theatres and contributed to higher advertising/promotions revenues from this segment.

- **Growth in cinema advertising:** Industry sources estimate that cinema advertising is another revenue stream related to films that will grow with the increasing popularity of multiplexes. Unlike on TV, advertising in movie halls guarantees a captive audience. Advertisers are choosing a film that has an overlap with their own target audience, sponsoring a corner of the multiplex, putting up a stall in its lobby, or simply advertising on the screen.

Multiplexes act as one of the anchor tenants in large malls and contribute to 40-50% increase in footfalls.

- **Organized retail boom:** Over the past few years, growth in the Indian retail market has been driven by the country's economic fundamentals; these include an increase in the proportion of upper income household, rising consumption expenditure, and greater use of credit cards. The retail business in India is likely to register healthy growth in the next few years; by the end of 2007, the number of shopping malls in India, Asia's third largest economy, are likely to rise to a staggering 358 with a total built up area of 87.8 million sq ft. Multiplexes, one of the anchor tenants in large malls, contribute to the increase in the footfalls by about 40-50%. We expect this boom in organized retail to result in the success of multiplex cinemas (and vice versa).

With state governments offering entertainment tax exemptions, many multiplex operators have charted out aggressive expansion plans.

- **Entertainment tax benefits:** State entertainment taxes in India were among the highest in Asia. This pressurized the profitability of many players in the exhibition business. As a result, exhibitors (especially the single-screen owners) have not been able to maintain and/or upgrade their cinema halls. The deteriorating quality of cinema halls had resulted in a lower number of patrons, further straining profitability levels. Therefore, in order to encourage investment in the film exhibition sector, many state governments have announced policies offering entertainment tax benefits. This has facilitated the growth of multiplex cinemas, while encouraging single-screen theatres to convert into multiplexes. The entertainment tax benefits offered by each state government is different; the availability of these exemptions would depend on compliance with certain conditions specified by the relevant state (Table 2). With various state governments offering entertainment tax exemptions, many multiplex operators have charted out aggressive expansion plans to expand their network of multiplexes.

Table 2. Entertainment tax exemptions in various states

	Entertainment tax exemption/benefit					Minimum seating	Minimum number of screens
	Year 1	Year 2	Year 3	Year 4	Year 5		
Mumbai	100%	100%	100%	75%	75%	1,250	4
Rest of Maharashtra	100%	100%	100%	75%	75%	1,000	3
Punjab	100%	100%	100%	100%	100%	1,000	3
Kolkata	100%	100%	100%	100%	N.A.	1,000	3
Rajasthan	100%	100%	90%	80%	N.A.	N.A.	N.A.
Uttar Pradesh	100%	100%	100%	100%	100%	N.A.	3
Bhopal/Indore/Jabalpur	100%	100%	100%	75%	50%	1,000	3

Source: Industry

Year 1 means first year of operations

Internal factors

- **Location** is a key aspect for the success of the multiplex business. A strong presence in important markets within a city or across cities, higher prices, and driving occupancies, are some factors that provide the theatre owner leverage with the distributor/production house in sourcing content and negotiating more favorable terms.

The condition of a theatre determines the ability of the theatre owner to charge higher ticket prices.

- **Quality of assets:** The quality of assets refers to the quality/condition of the theatre. A theatre with superior design, state-of-the-art layouts, projection angles, sight lines, stadium seating, projection and sound systems, and international quality large screens would be a far superior experience for the movie watchers than single-screen theatres. Softer features like superior ambience, tasteful interiors, and air conditioning, further add to the overall consumer experience. This also allows theatre owners to command higher ticket and concession prices over conventional theatres.

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Economic Advantages Of Multiplexes Over Single-Screen Halls

Multiplexes offer significant economic advantages over single-screen theatres. These are:

- **Better occupancy ratios:** Multiplex theatre have multiple screens with different seating capacities. The operator has the flexibility of screening the movie in larger or a smaller theatre, based on the expected potential of any particular movie. In this manner, the operator can maximize its capacity utilization levels, unlike its single-screen counterpart.
- **Greater number of shows:** Each movie has a different screening duration, for e.g. duration of foreign movies is less than domestic movies, especially in India. This enables the operator to schedule the screening of the movie so as to maximize the number of shows, generating a higher number of patrons.
- **Better revenue exploitation of movies:** Typically, a good movie has a large audience in the first week of its release. A multiplex operator could screen the movie on multiple screens in the first week, and then gradually reduce it to one screen in the largest cinema hall; the movie could be finally moved to the smallest cinema hall. This arrangement enables the multiplex operator to exploit the revenue potential of the movie in a better manner.
- **Leveraging on infrastructure:** A multiplex has the benefit of sharing facilities such as the box office, food & beverages, toilets, and manpower; this results in lower cost of overhead per screen.

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The multiplex business model

There are several forms of business arrangements to operate a multiplex. The choice of one form of business arrangement over another would largely be based on business, legal, tax, and other regulatory considerations. The main operating models for setting up and operating a multiplex are:

Ownership Model

In this model, the operator would own the property, built it to specifications, and then fit-out the multiplex. This model is suitable where the lease rentals are very high and where capital is available at a very low cost. It is easier to finance this model as there is a tangible security available. However, this model usually requires large capital investments. Inox Leisure is one such example; the company owns four properties.

Lease model

- Fixed Rental Model: In this model, the operator leases out the civic shell from the developer and invests in the fit-outs of the multiplex. Since the multiplex operator invests only in the fit-outs, as against the entire property, this model is more capital-efficient than the ownership model. This model is used by almost all the multiplex operators in the industry such as PVR, Shringar, and Adlabs.

- Fixed rental plus variable as a percentage of sales: This model is similar to the fixed rental model. However, the fixed rental paid to the developer in this case is lower than the rental paid in the fixed rental model. The multiplex operator compensates this by sharing a part of the revenues generated by the multiplex.

- Lease of existing theatres and conversion into a multiplex (Retrofit): In this model, the multiplex operator leases an existing theatre, refurbishes it, and converts it into a multiplex. The lease rentals in this model are generally lower.

In our view, the ownership model has an advantage over the lease model, as the company benefits from the escalating real estate prices and has a zero rental outgo. This, in turn, helps the multiplex operator to achieve higher profitability. In the lease model, however, the operator does not have to invest huge capital to purchase property but has to shell out rents; such an arrangement usually reduces the profitability of the operator.

Theatre management model

Shringar operates several single-screen theatres in Mumbai, based on the theatre management model.

In this model, a developer constructs the necessary infrastructure of the multiplex and outsources the operations to a multiplex operator for a fixed period of time. The multiplex operator charges a fixed fee or a share of the revenue/profits from the multiplex. For instance, Shringar Cinemas operates various single screen theatres in Mumbai; these include Globus, Gossip, Velocity, and Star City.

Revenues Sources For A Typical Multiplex

Ticket income, concession (F&B) income, and sponsorship (advertising) income are the three revenue streams for a multiplex. Ticket income is the largest contributor to the multiplex income pie. Over the past few years, theatre owners are increasingly giving importance to the income generated by the F&B segment. This is because the margins of this revenue stream are generally high. Advertising revenue is another major source of income for theatre owners. Each revenue source has been explained in detail below:

Ticket prices contribute 70% of the revenues of a multiplex operator.

- **Ticket prices:** Ticket sales contribute about 70% to the total revenues of a multiplex operator. Ticket prices for different exhibitors vary across various properties, according to the day and time of the week. Companies vary ticket prices based on their assessment of a film's potential popularity. Exhibitors implement a flexible ticket pricing strategy wherein lower ticket prices are charged between Mondays to Thursdays, when demand is less; higher prices are charged on Fridays, Saturdays, and Sundays. We believe that demand for cinemas is relatively price elastic between Mondays and Thursdays and relatively price inelastic on Fridays, Saturdays, and Sundays. The goal is to attract more patrons (thereby increasing occupancy rates) and increase box office revenues. The exhibitor's ability to increase ticket prices is restricted by competition from other cinema operators in the catchment area and the price sensitivity of the population in the area. In addition, in certain states, exhibitors are required to obtain an approval from their respective state governments before hiking ticket prices.

Sale of F&B commands a much higher margin than ticket sales.

- **Food & beverages**: Revenue from F&B is the second largest source of revenues for multiplex operators. As sales of F&B have a much higher margin than ticket sales, it is a highly profitable activity for any multiplex.

  F&B items include popcorn, soft drinks, confectionary, and sandwiches. The organized players in the industry offer 'combo-deals' for patrons - a pre-selected assortment of concession products. While pricing the products, exhibitors analyze the affordability of the products and price the products competitively.

- **Advertisements:** Advertisement revenue includes income from (1) on-screen advertisements, (2) off-screen advertisements and (3) cinema association activities. On-screen advertisements include 35mm film commercials and slides shown prior to the screening of a feature film and during intervals.

  Off-screen advertisements includes foyer displays, light box displays, advertisements on ticket backs, ticket jackets and popcorn boxes, and wash-room advertisements; advertisement spots on video walls, which feature film trailers, standard advertisements, concessions advertisements and music videos, can also be sponsored. Cinema association activities include the sponsorship of premiers or other events at cinemas and the sampling of advertiser products in conjunction with a feature film.

Costs involved in multiplex operations

Some of the main cost components of a multiplex include:

Entertainment tax is one of the largest cost components for a multiplex.

- Entertainment Tax: This is one of the largest cost components for a multiplex, except in cases where the entertainment tax rebate is available. This rebate is available in certain states, subject to the fulfillment of certain conditions. In case the rebate is available, the entire rebate adds to the profits of the multiplex operator.

Distributor's share, F&B, personnel cost, rentals, utilities, and marketing costs, comprise some of the other expenses of a multiplex operator.

- Distributor's share: Distributors are film content suppliers to exhibitors. A distributor's share is paid as a percentage of the total box office collections, after netting off all taxes (actual or notional). The distributor's share varies with relationship with the exhibitor, film content, and the distributor's deal with the producer.
- F&B: This is the cost incurred in sourcing various F&B from the vendors.

Table 3 indicates the economics of a typical multiplex.

Table 3. Economics of a typical multiplex

	Rs.mn	% of revenues		
Revenues			**Assumptions**	
Ticket sales	87.6	73.0	Number of seats	1,000
Concessions	24.0	20.0	Ticket price	120
Advertising	8.4	7.0	Average number of shows	5
Total revenues	120.0	100.0	Occupancy rate	40%
Costs				
Entertainment tax	26.3	21.9		
Distributor cost	24.5	20.4		
F&B cost	8.0	6.7	Operating margins	in %
Staff cost	7.2	6.0	With entertainment tax	15.0
Lease rental	12.0	10.0	Without entertainment tax	36.9
Other operating cost	24.0	20.0		
Total cost	102.0	85.0	ROI	in %
			With entertainment tax	12.5
EBITDA	18.0	15.0	Without entertainment tax	46.9
Depreciation	8.0	6.7		
EBIT	10.0	8.3		
Capital cost	80	66.7		
Working capital	Negative			

Source: IISL research,

Multiplex Magic

- **Personnel Cost:** Personnel cost includes salaries and other costs associated with employees and other workers at each theatre. This also includes the cost of training that is required to ensure the delivery of high service levels.
- **Rentals:** Typically, these are monthly rentals on long-term leases that are paid out to the property owner. This expense would not be seen in cases where the entire property has been bought out.
- **Utilities:** Utilities include electricity, water, and security charges, required for running the multiplex.
- **Marketing cost:** This includes spends on newspaper advertising, hoardings, posters, and the related creative cost.
- **Other Costs:** This includes other expenses like maintenance, telecommunication expenses, and IT.

Reduction in entertainment tax rate has a direct impact on EBITDA margins of any multiplex operator.

As seen from table 3, entertainment tax plays a critical part in the profitability of any typical multiplex. Reduction in the entertainment tax rate would increase the EBITDA margin and would also increase the return on investments. The EBITDA margins and RoI, however, would be different for different operators, as their expenses could vary.

Table 4. Multiplex players in the industry

Company	No. of properties	No. of Screens	No. of seats
PVR Cinemas	20	79	18,074
INOX Leisure	12	44	13,407
Shringar Cinemas	8	32	9,733
Adlabs Films	13	50	15,970
Wave Cinemas (Chadha group)	3	13	4,390
E city entertainment (Essel group)	4	17	n.a.
DT Cinemas	1	3	1,100

Source: IISL research

Currently there are seven major competitors in the film exhibition industry: PVR, Inox, Adlabs, Shringar, E City Entertainment, Wave Cinemas, and DT Cinemas. Table 4 outlines the number of screens and cinemas operated by each of these companies.

Multiplex Magic

The Indian film Industry

The Indian film industry, one of the largest in the world, generated revenues of more than Rs59bn in 2004.

The fortunes of the domestic multiplex industry are directly linked to growth in the Indian film industry, one of the largest in the world. In 2004, over 900 films were produced in India; these registered more than 3.1bn admissions. The estimated revenues generated during the year were Rs59 billion (US$ 1.3 billion); this was less than 1% of global film industry revenues and a small proportion of the U.S. film industry revenues ($9.49billion in 2003). The Indian film industry is expected to grow at 18 per cent per annum (in terms of revenues) for the next five years.

The Indian film industry currently realizes almost 70% of its total revenues from domestic and overseas box office sales. In contrast, the U.S. film industry earns only 35% of its revenues from box office sales and the remaining 65% from sale of DVDs and VHS tapes, and cable and satellite television rights.

The film industry comprises three industry sectors:

- Film production- making of movies
- Film distribution- distribution of movies to cinemas, television, and video stores
- Film exhibition- exhibiting movies in cinemas

Film production

One of the key drivers of the film exhibition and film distribution businesses is the content- MOVIES. In India, movie content is available in English, Hindi, and regional languages. The quantity and quality of movie content has a direct correlation with the success of film exhibition and film distribution businesses.

In 2004, over 900 films were released; Hindi films constituted the bulk of these releases followed by regional films in Telgu, Tamil, Kannada, and Malayalam. Hindi films are the most popular films in India and account for 40% of the total revenues of the Indian film industry.

Film distribution

The film distribution system in India is territory-based. The country is geographically divided into 14 distribution territories. Each territory has more than 50 distributors.

Film Exhibition

The film exhibition sector can be divided into single-screen, double-screen and multiplex cinemas. As of March 2005, there were around 12,000 cinemas in India; of these, 73 cinemas were multiplexes with a total of 276 screens.

Multiplex Magic

The Indian film exhibition sector

The average ticket in India costs US$0.20; in comparison, the average ticket in the U.S. (in 2005) is US$6.41.

The Indian film exhibition sector generated revenues of Rs. 59bn in 2004. (*Source: CII - KPMG Report, 2005*). The total reported domestic box office revenues, however, were lower than the U.S., despite the higher number of tickets sold in India. This is primarily because the movie tickets in India are among the cheapest in the world: the average ticket in India costs US$0.20; in comparison, the average ticket in the U.S. (in 2005) is US$6.41.The lower ticket prices in India can be attributed to the country's lower income levels, especially in rural and semi urban areas, and the lack of good quality cinema halls. The average price of a ticket for a multiplex cinema is Rs.75 - 85 but the number of screens in multiplexes represented only 2.3% of total screens in India as of March 2005. (*Source: Yes Bank Report*). Since an increase in the number of multiplex screens results in higher film exhibition revenues, we expect the opening of new multiplexes to be a significant growth opportunity for the industry. The total reported box office revenues in India is also lower compared with the U.S.; this is because the amount of revenue collected at the box office in India is under-reported on account of the fragmented and non-transparent nature of the film exhibition sector. Table 5 gives an overview of the Indian and the U.S. film industries, comparing them on various parameters.

Table 5. Comparison between Hollywood and Indian film industry

Year 2005	Hollywood	India
Films made per year	~550	~900
Admissions (bn)	1.4	3.0
Average ticket price	$6.41	$0.85
Box office revenue (bn)	$9	$1.10
Earnings of Top Film (mn)	$380	$9.60

Source: FICCI & PWC

During the recent years, the Indian film industry has been led by the growth in multiplexes. In 2004, India's largest 11-screen multiplex was opened in Bangalore. Various exhibition companies have aggressive plans of opening up more screens by way of new theatres or conversion of old, single-screen, theatres into multiplexes. Digital theatres are also coming up; over 100 digital cinemas have been opened till date. Digital projection is expected to lower the cost of distributing films to theatres significantly and, in turn, expand the box office market.

Given the advantage of large population base and low home-video penetration, India offers a huge base for growth in the home-video segment. India boasts of having over five mn home-video and DVD subscribers. This growth is further fuelled by expansion in the number of DVD households and falling DVD prices. The segment is expected to grow over 30 per cent in the next five years.

Multiplex Magic

Key concerns

Execution risk, changes in regulatory framework, piracy, and non-availability entertainment tax exemptions, remain some of the key concerns of multiplex operators.

- Execution is the biggest concern in the exhibition industry. Majority of the multiplexes are being set up on leased properties. Hence, multiplex operators have to depend on real estate developers. Any delay in the delivery of the civic shell (the internal structure of multiplex) could impact the operator's earnings.
- As the business is entirely state regulated, any change in the regulatory framework or any delay in the acquisition of licenses could affect the business.
- Piracy is another big concern for the film exhibition business as it directly affects business volumes.
- Entertainment tax is typically exempted for a period of five years. On the completion of this time frame, the tax paid by industry players is likely to increase significantly; this is particularly applicable for multiplexes launched a few years ago. In such a scenario, only industry players that consistently and successfully expand their presence in the domestic market, may benefit from tax exemptions on their new properties.

Conclusion

Given the potential growth and the expansion plans charted out by the four listed companies in the multiplex space, namely Adlabs, PVR, Inox, and Shringar, we are positive on the long term prospects of this industry.

We recommend a 'Buy' on PVR Limited, Shringar Cinemas, and Adlabs Films, based on the relative valuations of each company. We recommend investors to 'Hold' the Inox stock, given its expensive valuations and recent run up as compared with industry peers.

Adlabs Films Limited

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Riding on the multiplex boom: 'Buy' recommended

Adlabs Films Limited (Adlabs) is one of India's largest integrated players in the media and entertainment industry. During FY06-08E, we expect Adlabs' revenues and net profits to grow at a CAGR of 69% and 84% respectively. This increase is likely to be driven by the company's growing exhibition businesses and film production & distribution business. Moreover, the company has secured licenses to operate 45 radio stations across the country; this segment is likely to strengthen the Adlabs' revenue base in the long term.

At the current price of Rs373, the stock is trading at 22.9x FY07E and 16.4x FY08E earnings. We initiate our coverage on the stock with a 'Buy' recommendation.

- Leadership in film processing: Adlabs remains the unbeaten leader in the domestic film processing business with more than 60% share in western India. In FY06, the film processing business reported 42% EBIT margins and contributed more than 50% to the company's total revenues. We expect this business to grow at 15% p.a over the next few years.
- Increased focus on film exhibition: In H1FY07, the company commissioned four new properties and 12 screens. The company plans to set up more than 80 screens by FY07E and 250 screens by 2009, up from the current level of 50 screens across India.
- Tie-ups in film production business: Adlabs has tied up with big names such as Ramesh Sippy and Prakash Jha, for the production of movies under the *Adlabs* banner. For the next few years, the company intends to invest more than Rs500-600mn per annum in the film production division.
- Overseas and domestic distribution of movies: For FY07E, Adlabs has rights for international distribution of five big banner movies. The company intends to release 16-18 films every year, the highest by any distributor in India.

Shareholding (%)

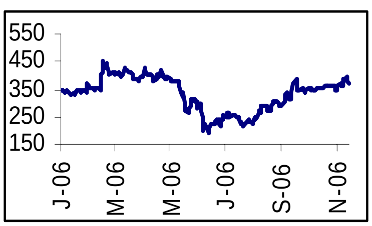
Promoters	54.9
FII's	12.6
MFs	5.4
Others	27.1

Share price performance

52-week high/low (Rs)	474 / 172		
	-1m	-3m	-12m
Abs (%)	4.6	30.4	26.4
Rel* (%)	0.5	14.9	-23.7

*to Nifty

Stock chart



Buy

Rs373

November 15, 2006

Market cap
Rs bn 15
US$ mn 330

Avg 3m daily volume
414,380

Avg 3m daily value
USD mn 3.2

Shares outstanding (mn)
40

Reuters
ADLF.BO

Bloomberg
ADLF IN

Sensex
13,469

Nifty
3,876

Year-end	Sales	YoY	EBITDA	YoY	NP	EPS	YoY	PE	EV/EBITDA	PSR	PBR	RoE	RoCE	DPS	Div Yield
March	(Rs m)	(%)	(Rs m)	(%)	(Rs m)	(Rs)	(%)	(x)	(x)	(x)	(x)	(%)	(%)	(Rs)	(%)
FY2005	957	-	407	-	194	10	-	38.8	10	16	3.2	16.5	22.5	7.6	2.0
FY2006	1,213	27	435	7	281	7	-27	53.1	27	12	2.2	8.3	4.1	5.1	1.4
FY2007E	2,249	85	783	80	649	16	132	22.9	15	7	1.9	16.6	7.0	5.1	1.4
FY2008E	3,578	59	1,303	67	904	23	39	16.4	9	4	1.6	19.2	10.3	5.1	1.4

Adlabs Films Limited

Investment Rationale

Adlabs is the market leader in film processing with a 60% market share in western India.

- **Leadership in film processing**: Adlabs continues to be the market leader in the domestic film processing business with more than 60% market share in western India. The division has grown at an average rate of 19% over the past five years, driven by robust growth in the Indian entertainment sector. In FY06, the film processing business reported 42% EBIT margins and contributed more than 50% to the company's topline. In 2006, Adlabs acquired the Chennai-based Vijaya Labs to expand its processing operations in South India. Moreover, the company's Kolkata processing operations are likely to be operational from November 2006, supporting the division's revenues. Given the linear nature of the business, we believe that this division may continue to grow at 15% per annum and may constitute more than 25% of the company's topline in FY08E.

In H1FY07, Adlabs commissioned four properties with 12 screens; the company is likely to set up more than 250 screens by 2009.

- **Increased focus on film exhibition:** In line with the strong growth prospects of the multiplex industry, Adlabs has increased its focus on the film exhibition business. In H1FY07, the company commissioned four properties with 12 screens. Adlabs plans to set up more than 80 screens by FY07E and 250 screens by 2009, up from the current level of 50 screens (see table 1 and 2). Adlabs is funding this expansion through a mix of equity and internal accruals; for this purpose, the company has raised USD100mn through an FCCB issue (initial conversion price set at Rs543.42). We expect the exhibition business to contribute more than 60% to the company's topline in FY08E as against 33% in FY06.

Table 6. Existing multiplexes

Location	Seats	Screens
Imax Adlabs	1,832	5
R-Adlabs	1,353	4
Divya Adlabs	1,200	3
Gold Adlabs	1,109	3
Huma Adlabs	1,263	4
Aerens R Imax at Rap Adlabs	1,313	4
Fame Adlabs	1,282	5
Cineplex Adlabs	1,076	3
Rap magnum mall	1,027	3
Mehul Adlabs	980	3
Ansal Vaishali Plaza	942	3
Metro Adlabs	1,491	6
Mangal Adlabs	1,102	4
Total	15,970	50

Source: IISL research, company

Adlabs Films Limited

Table 7. Upcoming properties

Location	Seats	Screens
Goldspot Adlabs	1,362	4
Adlabs Palm Beach	1,008	4
Himalaya Adlabs	1,200	5
RDB Boulevard	1,050	3
IMAX, Mani Square	1,350	4
Ansal Mall	1,200	4
Gopalan Legacy Adlabs	1,100	4
Dattani Mall	1,100	4
Sangam Adlabs	1,250	4
R Town	2,200	8
Fortune City Mall	2,200	8
Ansal Plaza	1,000	3
Maheshwari - Parmeshwari Adlabs	1,600	5
RAP, Borivali	1,250	4
Rap Mirage	1,004	3
RAP Media Ltd	1,700	6
RAP Media Ltd	1,500	5
RAP Media Ltd	2,000	7
RAP Media Ltd	1,500	5
RAP Metropolitan	1,016	3
RAP Media Ltd	1,450	5
Little world Mall	1,200	4
Paras Downtown	1,300	4
Total	31,540	106

Source: IISL research, company

At 23%, Adlabs' EBITDA margins are amongst the highest in the industry.

- Adlabs' EBITDA margins in the film exhibition segment, at around 23%, are the second best in the industry after Inox Leisure Limited. We believe that the division's EBITDA margins would be impacted in FY07E due to the expiry of the entertainment tax exemption period on few of its multiplexes. In FY08E, however, the division's margins may improve, as 70-75% of its new multiplexes would enjoy entertainment tax exemptions.

Adlabs has secured 45 licenses to open radio stations across the country.

- **Aggressive foray into radio broadcasting business:** Adlabs has aggressively entered the radio broadcasting business by securing 45 licenses to open radio stations across the country. The company has already launched four radio stations and plans to launch all the stations by March 2007. We have not factored in the revenues from this business in our projections. Nevertheless, this business is expected to contribute significantly to Adlabs' bottomline after two-three years. Adlabs plans to hive off this division into a separate listed entity; we believe that this move will be beneficial to the company's shareholders.

- **Tie-ups in film production business to support overall revenues:** Adlabs has tied up with big names in the film industry for the production of movies under the *Adlabs* banner. Some of these names include film-makers such as Ram

Adlabs has tied-up with big film producers and intends to invest Rs. 500-600mn each year in the film production division.

Gopal Varma, Vipul Shah, Prakash Jha, and Ramesh Sippy (see table 8). Recently, Adlabs also entered into an agreement with Hydepark Entertainment, an Ashok Amritraj promoted venture, for the co-production of Hollywood films. This deal will enable Adlabs to enter the international arena of film production. The company intends to invest Rs500-600mn each year in the film production division.

Table 8. Films produced under Adlabs banner

Movie production	Directors
Gangaajal (released in 2006)	Prakash Jha
Bluffmaster (released in 2006)	Rohan Sippy
Apaharan (released in 2006)	Prakash Jha
Waqt (released in 2006)	Vipul Shah
Taxi no. 9211 (released in 2006)	Milan Luthria
Nishabd	Ram Gopal Varma
Sarkar 2	Ram Gopal Varma
Namaste London	Vipul Shah
Sholay 2	Ram Gopal Varma
International production	**Comment**
Marigold (venture)	Willard Carroll films

Source: IISL research, company

In order to increase its presence in South India, Adlabs has acquired a Chennai-based processing company and signed two co-production deals for Tamil films.

- **Entry into South India –a major film market after bollywood:** Adlabs plans to enter South India, one of the fastest growing film markets of India. For this purpose, Adlabs has acquired the Chennai-based Vijaya labs, a film processing company. Adlabs has entered into film production business in the region by signing two co-production deals for Tamil films, including one animation film. On the exhibition front, the company already manages three screens at Cineplex Adlabs in Mangalore. It is in talks with property developers in almost all major cities in South India.

Adlabs plans to release 16-18 films every year, the highest by any distributor in India.

- **Overseas & domestic distribution of movies:** For FY07E, Adlabs has rights for international distribution of several big banner movies (see table 9). Adlabs enjoys a ROI of 15-20% in the overseas distribution business. The company intends to release 16-18 films every year, the highest by any distributor in India. If successfully executed, Adlabs' growth plans will shore up its revenue base significantly.

Adlabs Films Limited

Table 9. Films distributed by Adlabs

Distribution	Director
Anthony Kaun Hai	Raj Kaushal
Bus Ek Pal	Onir
Woh Lamhe	Mohit Suri
Killer	Raksha Mistry & Hasnail Hyderabadwala
Dil Apna Punjabi	Manmohan Singh
Krrish	Rakesh Roshan
Guru (to be released)	Mani Ratnam
Jaan-E-Mann	Shirish Kunder
Umrao Jaan	J.P. Dutta
Vivah	Suraj Barjatya
Baabul (to be released)	Ravi Chopra's

Source: IISL research, company

Adlabs Films Limited

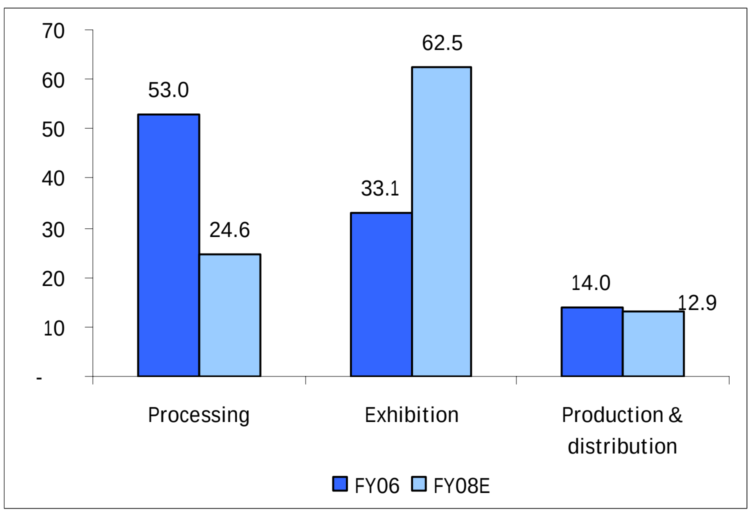
Background

Adlabs has grown from a motion picture processing laboratory to one of the leading integrated players in the film industry.

Adlabs was founded in 1978 as a motion picture processing laboratory in Mumbai. Today, Adlabs is the largest processor of Hindi movies in India. In 2000, Adlabs entered into the film exhibition business with the setting up of a 518-seat, IMAX dome theatre, along with Mumbai's first multiplex. Subsequently, it made a successful foray into production of Hindi movies through its subsidiary, Entertainment One. Adlabs has issued FCCBs worth USD100mn – the largest ever by any media company. It is likely to utilize this money for funding business growth across segments, further strengthening its position as one of the country's leading integrated media and entertainment companies. In 2005, the Reliance Anil Dhirubhai Ambani group (Reliance- ADA Group) acquired a 50.16% stake in Adlabs, for a price of Rs3.6bn. The Reliance-ADA Group plans to expand its presence across the entertainment value chain, ranging from television to radio and DTH.

Adlabs has three lines of business viz. film processing, movie production and distribution, and film exhibition. Chart 8 gives the revenue break-up of these business segments.

Chart 8. Revenue break-up (%)



Source: IISL research, company

Adlabs Films Limited

New Developments

Adlabs recently entered into the TV content creation segment by acquiring a majority stake in Synergy Communications.

Foray into TV content creation: Recently, Adlabs forayed into TV content creation by acquiring a majority stake in Synergy Communications, a Siddharth Basu promoted company. Over the years, company has aired over 30 television series and has produced over 2000 hours of content. Synergy Communications has also produced several popular shows like Kaun Banega Crorepati, India's Child Genius, University Challenge, Mastermind India, Kamzor Kadi Kaun, Jaane Kya Tune Kahi, and Aao Guess Karen. In addition, the company has organized live shows (Channel V Awards 97-98) and has successfully published the Mastermind series.

An Rs350mn deal signed with Hrithik Roshan: Recently, Adlabs entered into one of the biggest deals in the Indian movie industry, by signing Hrithik Roshan for three films (contract pegged at Rs350mn). We believe that with this move, the Indian film industry is slowly adopting a model wherein a production house signs an actor for the various films it produces; this is a deviation from the normal practice in the industry, wherein a standalone producer signs an actor only for one particular film.

Entry into animation: Adlabs forayed into animation business and collaborated with the Chennai-based Ocher studios Private Limited; Ocher Studios, headed by Smt. Latha Rajinikanth, is a leading post-production studio servicing the southern film industry. Adlabs, in collaboration with this studio, intends to co-produce an ambitious animation project featuring the southern superstar Rajinikanth (Table 10). The project is targeted at Indian and international markets.

Table 10. Animation films under production

Animation	Comment
Superstar	Co production
Gini and Jony	Co production

Source: IIL research, company

Adlabs Films Limited

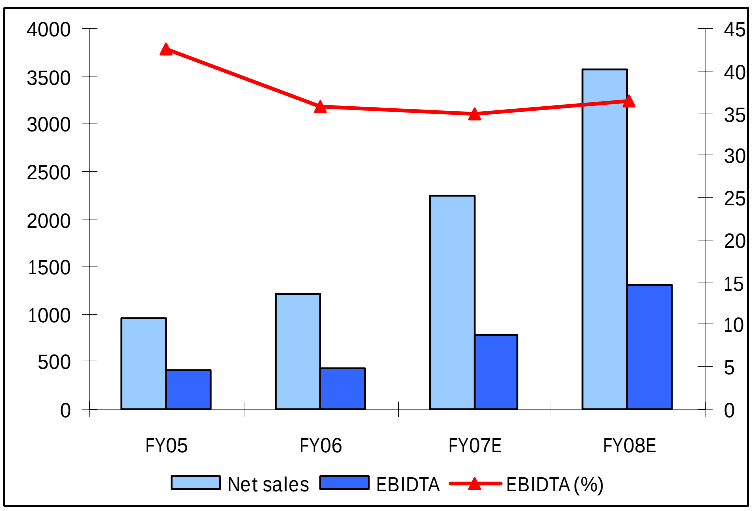
Financial Profile

On a consolidated basis, Adlabs recorded a revenue growth of 27%YoY to Rs1212mn for FY06. The increase in revenues was mainly driven by the 30% YoY growth in the exhibition business; the segment contributed 33% to the company's topline in FY06. Adlabs' processing business, which contributed more than 50% to its net sales, grew by 4.6% YoY in FY06. The company's film production and distribution business comprised 14% of its topline in FY06, up from 1.3% in FY05.

Adlabs recorded a revenue growth of 27% YoY for FY06. In H1FY07, the company's net sales and net profits increased by 132% YoY and 177% YoY respectively.

For H1FY07, Adlabs registered net sales and net profits of Rs1011.4mn and Rs325mn, an increase of 132% and 177%YoY, respectively. The company's EBITDA grew 84%YoY to Rs330mn. EBITDA margins, however, dropped from 41% to 32.6% in H1FY07 due to high other expenses arising from the launch of new multiplexes during the year. During H1FY07, Adlabs' processing business and film exhibition businesses grew 13%YoY and 186%YoY respectively. The company's film production and distribution businesses grew phenomenally from Rs9.9mn to Rs336mn. Chart 9 depicts Adlabs' financial performance during FY05-FY08E.

Chart 9. Financial performance



Source: IISL research, company

Adlabs Films Limited

Valuations

Given Adlabs' strong prospects in the fast-growing film industry, we recommend a 'Buy' on the stock.

During FY06-08E, we expect Adlabs' revenues and net profits to grow at a CAGR of 69% and 84% respectively. The company's EBITDA margins are expected to drop to 34.8% in FY07E as some of its multiplexes would no longer be exempt from entertainment tax. However, in FY08E, EBITDA margins are expected to increase to 36.3% due to a lower entertainment tax burden.

Given Adlabs' integrated presence in the film industry, we believe that the company should reap the benefits from the growing demand of entertainment and leisure activities. The de-merger of radio business would further unlock the company's value.

In FY08E, the company's is expected to report RoE and RoCE of 19.2% and 10.3% respectively. The company's low RoCE levels can be attributed to its investments in radio business; these investments have not been considered in our valuations.

Currently, the stock is trading at 22.9xFY07E and 16.4xFY08E earnings. We initiate coverage on the stock with a 'Buy' recommendation.

Adlabs Films Limited

Financials

Profit & Loss

Rs mn	FY05	FY06	FY07E	FY08E
Net sales	957.2	1,212.6	2,249.2	3,578.3
YoY (%)		26.7	85.5	59.1
Total expenses	550.0	777.4	1,466.6	2,275.1
Traded Goods Purchased	0.0	0.0	0.0	0.0
Film distributing & produ	0.0	21.1	160.7	161.5
Processing expenses	268.3	281.6	342.3	393.6
Expenses- Theatre operat	112.7	147.7	378.8	789.6
Employee Costs	59.1	76.2	135.0	214.7
Administrative expenses	109.9	250.9	449.8	715.7
EBIDTA	407.2	435.1	782.7	1,303.2
YoY (%)		6.8	79.9	66.5
EBIDTA (%)	42.5	35.9	34.8	36.4
Other income	11.3	98.6	341.2	333.0
PBIDT	418.5	533.7	1,123.9	1,636.2
Interest	15.9	15.9	10.5	11.6
Gross profit	402.6	517.8	1,113.4	1,624.6
Depreciation	62.0	99.7	181.2	326.1
PBT and extra ordinary	340.6	418.1	932.2	1,298.4
Extra ordinary items	(1.2)	(0.4)	0.0	0.0
PBT	339.5	417.6	932.2	1,298.4
(-) Tax	132.4	138.0	282.8	393.9
Tax/ PBT	39.0	33.0	30.3	30.3
PAT	207.1	279.7	649.4	904.5
Profit after minority intere	194.1	280.5	649.4	904.5
YoY (%)	0.0	44.5	131.5	39.3

Balance Sheet

Rs mn	FY05	FY06	FY07E	FY08E
Equity capital	107.5	199.0	199.0	199.0
Preference capital	0.0	0.0	0.0	0.0
Reserves	1,150.3	3,158.3	3,706.7	4,510.1
Net worth	1,257.8	3,357.3	3,905.7	4,709.1
Total borrowings	276.7	4,728.1	4,746.3	4,753.5
Deferred tax	86.2	78.1	62.6	41.1
Total liabilities	1,620.6	8,163.5	8,714.6	9,503.7
Gross block	1,006.5	1,252.3	2,898.3	4,572.5
Less: Acc. depreciation	225.0	332.9	514.1	840.2
Net block	781.6	919.4	2,384.2	3,732.3
CWIP	61.8	2,279.9	1,279.9	679.9
Investments	166.5	4,384.4	3,642.2	3,538.7
Current assets	1,234.3	2,353.3	2,658.8	2,803.6
Inventories	9.5	58.3	60.3	93.5
Debtors	368.4	576.4	838.1	949.8
Cash	28.7	253.6	300.0	300.0
Loans and advances	827.7	1,465.1	1,460.4	1,460.4
Current liabilities	254.8	231.6	154.1	154.5
Provisions	368.7	1,542.0	1,096.4	1,096.4
Net current assets	610.8	579.7	1,408.3	1,552.8
Miscellaneous expenses	0.0	0.0	0.0	0.0
Total assets	1,620.6	8,163.5	8,714.6	9,503.7

Key Ratios

	FY05	FY06	FY07E	FY08E
EPS (Rs)	9.6	7.0	16.3	22.7
Adjusted EPS (Rs)	0.0	0.0	0.0	0.0
CEPS (Rs)	12.5	9.4	20.5	30.4
Book value (Rs)	117.0	168.7	196.3	236.6
Dividend per share (Rs)	7.6	5.1	5.1	5.1
Debt-equity (x)	0.2	1.4	1.2	1.0
ROCE	22.5	4.1	7.0	10.3
ROE	16.5	8.3	16.6	19.2
Valuations				
PE (x)	38.8	53.1	22.9	16.4
Cash PE (x)	29.9	39.8	18.2	12.3
Price/book value (x)	3.2	2.2	1.9	1.6
Dividend yield	2.0	1.4	1.4	1.4
Market cap/sales	4.2	6.1	3.3	2.1
EV/sales (x)	4.5	9.8	5.3	3.3
EV/EBDITA (x)	10.5	27.4	15.2	9.1

Cash Flow

Rs mn	FY05	FY06	FY07E	FY08E
Net profit	194.1	280.5	649.4	904.5
Depn and w/o	62.0	99.7	181.2	326.1
Deferred tax	12.3	(6.9)	(15.5)	(21.6)
Change in working cap	(200.4)	256.0	(782.1)	(144.5)
Other income	11.3	98.6	341.2	333.0
Operating cash flow	79.3	727.9	374.2	1,397.5
Other income	(11.3)	(98.6)	(341.2)	(333.0)
Capex	(110.7)	(2,455.7)	(646.0)	(1,074.2)
Investments	(117.5)	(4,218.0)	742.2	103.5
Investing cash flow	(239.5)	(6,772.3)	(245.0)	(1,303.7)
Dividend	(82.1)	(102.1)	(101.0)	(101.0)
Fresh equity	(91.3)	1,743.1	0.0	0.0
Debt	133.0	4,451.4	18.2	7.2
Financing cash flow	(40.4)	6,092.3	(82.8)	(93.8)
Others	121.8	177.0	0.0	0.0
Net change in cash	(78.9)	225.0	46.4	(0.0)
Opening cash	107.5	28.7	253.6	300.0
Closing cash	28.7	253.6	300.0	300.0

Entertainment

Inox Leisure Limited

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Fundamentals intact ; Valuations appear stretched

Inox Leisure Limited (ILL) is one of India's leading film exhibition companies, operating a chain of multiplexes across the country under the brand *Inox*. ILL is likely to set up 11 new multiplexes by FY08; if successfully executed, these expansion plans should enhance ILL's domestic presence significantly.

At the current market price of Rs183, the stock is trading at 35.4x FY07E and 24.7xFY08E earnings. We expect the company's earnings to register a growth of 59% CAGR during FY06-08E. We are positive on the stock, given the favorable prospects of the entertainment industry and the anticipated growth in the company's earnings. However, we believe that at Rs185, the stock is fairky priced; hence, we initiate coverage on ILL with a 'HOLD' rating.

- **Aggressive expansion plans:** ILL intends to set up 11 new multiplexes by 2008, adding to the existing 12 multiplexes. The proposed expansion plan would increase the number of screens from 44 to 98, and number of seats to more than 25,000 by FY08E.
- **Robust growth in revenues anticipated:** ILL's expansion plan is likely to translate into a revenue growth of 52% CAGR over the next two years. The company's EBITDA is expected to grow at 48% CAGR for FY06-08E.
- **Tie up with Pantaloon group of companies to support expansion:** Under ILL's tie-up with Pantaloons, ILL would have an option to operate a multiplex at all Pantaloon malls. We believe that this tie up will support ILL's proposed expansion plans, should it choose to exercise the option under the tie-up.
- **Highest margins amongst peers:** ILL's operating margins, in the range of more than 30%, are the highest among its peers. This is due to the savings on lease rentals arising from the setting up of some multiplexes on owned properties.

Shareholding (%)

Promoters	66.0
FII's	12.2
MFs	4.2
Others	17.6

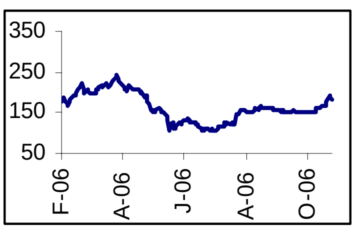
Share price performance

52-week high/low (Rs) 253/86

	-1m	-3m	-12m
Abs (%)	20.4	17.5	na
Rel* (%)	16.3	1.9	na

*to Nifty

Stock chart



Hold

Rs183

November 15, 2006

Market cap
Rs bn 11
US$ mn 244

Avg 3m daily volume
359,116

Avg 3m daily value
USD mn 1.3

Shares outstanding (mn)
60

Reuters
INOL.BO

Bloomberg
INOL IN

Sensex
13,469

Nifty
3,876

Year-end	Sales	YoY	EBITDA	YoY	NP	EPS	YoY	PE	EV/EBITDA	PSR	PBR	RoE	RoCE	DPS	Div Yield
March	(Rs m)	(%)	(Rs m)	(%)	(Rs m)	(Rs)	(%)	(x)	(x)	(x)	(x)	(%)	(%)	(Rs)	(%)
FY2005	606	-	216	-	81	2	-	102	42	14	13.9	13.7	11.7	-	-
FY2006	1,021	69	360	66	175	3	63	62	33	11	5.1	8.1	9.5	-	-
FY2007E	1,746	71	597	66	310	5	77	35	20	6	4.4	12.6	15.3	-	-
FY2008E	2,346	34	788	32	444	7	43	25	15	5	3.8	15.2	18.3	-	-

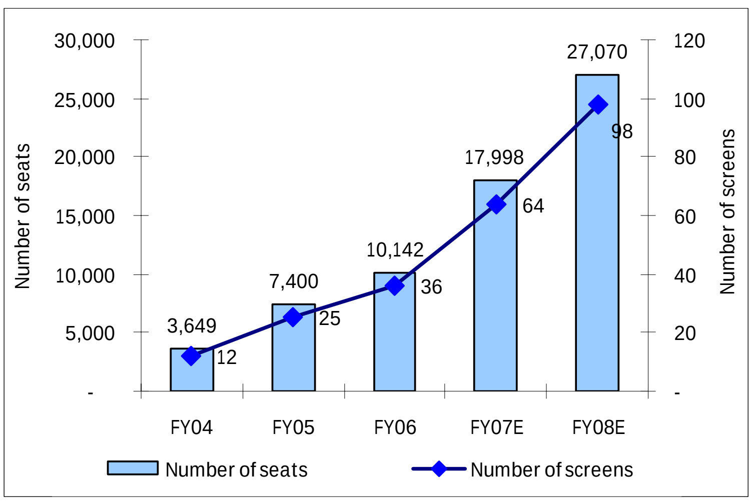
Inox Leisure Limited

Investment Rationale

ILL intends to add 11 multiplexes by 2008, taking its total multiplexes from 11 to 23 and the number of screens from 44 to 98.

- **Aggressive expansion plans:** ILL's multiplexes are located in 11 cities across states such as Maharashtra, Gujarat, Kolkata, Goa, Karnataka, and Rajasthan. Going forward, it plans to enter states like Madhya Pradesh, Tamil Nadu, Uttar Pradesh, Andhra Pradesh, and Chattisgarh (see table 1). The company's recent merger with Calcutta Cinema Private Limited (CCPL), a multiplex operator based in West Bengal, is also likely to support ILL's presence in the Eastern region. As per its expansion plan, ILL intends to set up 11 more multiplexes by 2008, up from the current 12 multiplexes. The proposed expansion plan would increase the number of screens from 44 to 98, and number of seats to more than 27,000 by FY08E (see chart 10). This translates to a growth of 63% CAGR for FY06-08 in terms of seats. To fund this expansion, ILL has already raised Rs1.4bn through an IPO in February 2006. We believe that ILL's expansion plans, if successfully executed, will significantly enhance its domestic presence by making it a pan-India player.

*Chart 10: **ILL's expansion plan***



Source: IISL research, company

ILL's revenues are likely to increase by 52% CAGR during the next two years.

- **Robust growth in revenues anticipated:** ILL's expansion plan is likely to translate into a revenue growth of 52% CAGR over the next two years. Revenues are expected to increase by 71% in FY07 to Rs1746mn and by 34% in FY08 to Rs2346mn. The company's EBITDA is expected to show a growth of 48% CAGR for FY06-08E. ILL's net profit is likely to grow at 59% CAGR for FY06-08E.

Table 11. ILL's expansion plans

Location	City	Screens	Seats
Chennai	Tamil Nadu	5	1,156
Hyderabad	Karnatka	6	1,470
Lucknow	Uttar pradesh	4	1,000
Vishakhapatnam	Andhra pradesh	4	1,300
Jaipur	Rajasthan	3	750
Bangalore	Karnatka	4	1,100
Raipur	Chattisgarh	4	1,250
Jaipur	Rajasthan	3	750
Kharagpur	Kolkata	4	1,200
Koramangla	Karnatka	7	1,860
Kolkata	Kolkata	5	1,042
Malleshwaram	Karnatka	7	1,720
Jodhpur	Rajasthan	4	1,250
Total		**60**	**15,848**

Source: IISL research, company

Under its tie-up with Pantaloon, ILL would be offered multiplex space on a preferential basis in any new mall developed by Pantaloon. This tie-up is likely to support ILL's growth plans, going forward.

- **Tie up with Pantaloon group of companies to support expansion:** Pantaloon group of companies (Pantaloon) is one of India's leading retail chains with stores across the country's major cities. ILL has signed a two-pronged alliance with Pantaloon under which ILL would have an option to operate a multiplex at all Pantaloon malls; ILL would be offered multiplex space on a preferential basis in any new mall developed by Pantaloon. Also, Pantaloon would take ILL's inputs on key parameters like the layout and design of multiplexes within malls. We believe that this tie up will support ILL's expansion plans over the next two years, should it choose to exercise the option under the tie-up. Currently, more than 50 malls are being promoted by Pantaloon (as part of the Kshitij fund); out of these, more than 30 malls have a multiplex as part of its mall plan. This alliance would give an option to ILL to open Inox multiplexes in the cities it is not present in currently. The properties acquired through this alliance will be in addition to the properties that ILL has locked in on its own, thus increasing its reach across India exponentially.

Location in posh areas and savings on lease rentals have translated into strong EBITDA margins for ILL; the company's EBITDA margins have been in the range of more than 30%, much higher than its peers.

- **Highest margins amongst peers:** ILL multiplexes are located at the prime locations across the country. This gives it the power to charge a premium on tickets and on F&B. For example, ILL owns a property at Nariman point, Mumbai, one of the most posh areas of the city. Moreover, unlike other multiplex operators, some of ILL's existing multiplexes are set up on owned properties, translating into significant savings on lease rentals. Not surprisingly, ILL's operating margins are the highest amongst its peers. All other industry players are operating at an EBITDA margin in the range of 14-16%; in comparison, ILL is operating at a range of more than 30% EBITDA margins. Despite investing heavily in purchasing its own properties, ILL's RoCE is highest among the peers (FY08E RoCE of 18.3%) due to its strong margins and profitability. ILL intends to set up all its upcoming properties on lease basis; this is likely to increase its rent burden and pressurize its margins, going forward.

Background

ILL opened its first multiplex in Pune on May 10, 2002. Today, ILL operates 12 multiplexes across 11 cities in India.

ILL was incorporated in 1999; the company became a subsidiary of Gujarat Flurochemicals Limited (GFL) in 2000 as part of the growth and diversification strategy of GFL. Mckinsey & Co was mandated to help GFL identify business opportunities. Based on the Mckinsey study, GFL invested in the entertainment industry by setting up a national chain of multiplexes. Today, ILL is a leading operator of a national chain of world class multiplex theatres under the brand name *INOX*. ILL opened its first multiplex in Pune on May 10, 2002. Today, INOX is successfully running 12 multiplexes in 11 cities, with 44 screens, making it the only national multiplex chain. The company's multiplexes are located at Pune (Bund Garden Road), Vadodara (Racecourse Circuit Road), Kolkata (FORUM, Elgin Road and at City Centre- Salt Lake City), Goa (Campal, Panaji), Mumbai (CR2, Nariman Point), Bangalore (Garuda Mall, Magrath Road), Jaipur (Vaishali Nagar), Indore (Sapna, Sangeeta Road), Darjeeling (Rink Mall) and Nagpur (Poonam Mall, Wardhaman Nagar). Winner of the 'ICICI Entertainment Retailer of the Year' Award 2005, ILL is likely to continue its expansion into Chennai, Hyderabad, Raipur, Lucknow, Vizag and Kharagpur.

Table 2 below shows the number of screens and seating capacities of each multiplex operated by the company.

Table 12. Existing multiplexes

Location	City	Screens	Seats
Pune	Maharashtra	4	1,316
Vadodra	Gujarat	4	1,318
Kolkata	Kolkata	4	1,000
Salt lake	Kolkata	4	1,200
Goa	Goa	4	1,272
Mumbai	Maharashtra	5	1,335
Bangalore	Karnatka	5	1,103
Jaipur	Rajasthan	2	787
Darjelling	Uttranchal	3	811
Indore	Madhya pradesh	3	1,080
Nagpur	Maharashtra	3	1,068
Kota	Rajasthan	3	1,117
		44	**13,407**

Source: IISL research, company

Inox Leisure Limited

Distribution Business

The distribution business complements ILL's mainstream exhibition business; distribution revenues comprised 7% of the company's total revenues in FY06.

ILL entered the film distribution business in FY06. The business contributed 7% to the company's topline during the year. The company also acquired distribution rights of Hindi film titles such as *Rang De Basanti*, *Gangster*, *Family*, *Apharan,* and *Garam Masala* during the year. The distribution business complements and synergizes with ILL's mainstream exhibition business, supporting the company's overall business position in the domestic entertainment industry.

Merger of CCPL with ILL

Recently, ILL entered into an all-share-swap deal with Calcutta Cinema Private Limited (CCPL); as per this deal, the operations of CCPL would be merged with that of ILL. The Boards of ILL and CCPL have approved the issue of 33 equity shares of Rs10 each of ILL, for every one equity share of Rs1000 of CCPL.

Recently, ILL tied up with CCPL that operates under the brand '89 Cinemas' in Eastern region of India. The proposed merger will further enhance ILL's pan-India presence.

CCPL, which runs its business under the brand *89 Cinemas*, operates a 4-screen multiplex at Swabhumi in Kolkata; the company is likely to commence its second 3-screen multiplex at Durgapur (West Bengal), shortly. In addition, CCPL has tied up properties for building and operating six other multiplexes in West Bengal and Assam. CCPL also has an understanding with Bengal Ambuja Housing Development Limited (Bengal Ambuja), a leading real estate developer in East India; this gives CCPL preferential access as the preferred multiplex operator to all properties developed by Bengal Ambuja.

With this proposed merger, ILL will further enhance its pan-India presence in the movie exhibition segment in East India. ILL currently operates two multiplexes in Kolkata (Elgin Road and Salt Lake) and one in Darjeeling (Laden La Road). ILL plans to open new multiplexes in Kolkata at Diamond City, Jessore Road (with five screens), and at Kharagpur (with four screens). The agreement with CCPL will take ILL's tally of multiplexes in West Bengal and Assam to 13.

Financial Profile

Addition of five new multiplexes that became operational in FY05 and FY06 increased the company's revenues by 69% YoY during FY06. During H1FY07, the company's net sales and net profits increased by 49% YoY and 58% YoY respectively.

In FY06, on a consolidated basis, ILL recorded a revenue growth of 69% YoY to Rs1021mn. This growth was mainly driven by the company's five new multiplexes that became operational during FY05 and FY06.

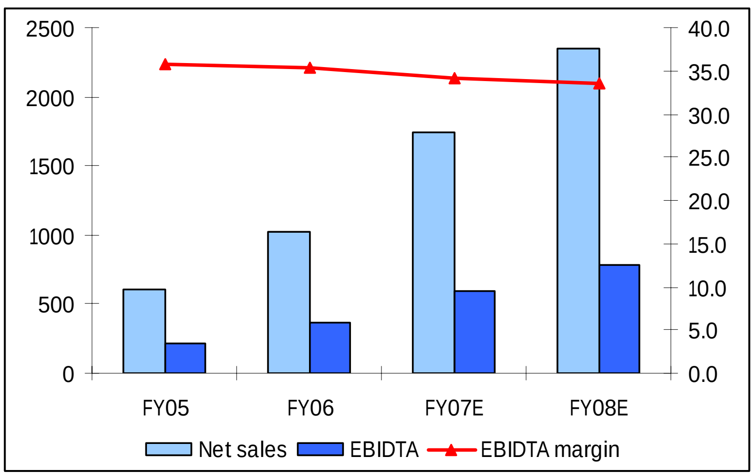
For FY06, ILL's EBITDA increased 66.4% to Rs360mn as against Rs216.4mn in FY05. However, its EBITDA margins dropped 40bps, from 35.7% in FY05 to 35.3% in FY06. At the net profit level, ILL reported a growth of 117%YoY to Rs176mn in FY06, up from Rs81mn in FY05.

Inox Leisure Limited

For H1FY07, ILL reported net sales and net profits of Rs747mn and Rs153mn, an increase of 49% and 58%YoY, respectively. This increase was driven by the addition of five new multiplexes and incremental growth in the existing cinemas. ILL's EBITDA increased marginally; this is because, during H1FY07, the company's entertainment tax outgo and costs incurred in the distribution business increased significantly. This also impacted the EBITDA margins that dropped from 40.2% in H1FY06 to 27.4% in H1FY07. During H1FY07, ILL's net sales grew by 48% and EBITDA increased marginally. ILL's net profits, however, increased 58%YoY to Rs153mn in H1FY07, as against Rs97mn in H1FY06. This growth was driven by the company's other income that increased from Rs5.6mn in H1FY06 to Rs58mn in H1FY07.

During FY06-08E, we expect ILL's revenues and net profits to grow by 52% and 59% CAGR respectively, contingent on the execution of its expansion plans. Chart 2 depicts ILL's financial performance during FY05-FY08E.

Chart 11. Financial performance (Rs mn)



Source: IIL research, company

Valuations

We recommend a 'Hold' on the stock as we believe that the stock, at Rs. 183, is priced fairly.

We expect ILL's revenues and net profits to grow by 52% and 59% CAGR respectively during FY06-08E, depending on the successfully execution of its expansion plans. The merger of ILL with CCPL, and ILL's tie-up with Pantaloon, would give ILL a significant upside in terms of earnings, going forward.

At the current market price of Rs183, the stock is trading at 35.4x FY07E and 24.7xFY08E earnings. We expect the company's earnings to register a growth of 59% CAGR during FY06-08E. Given the favorable prospects of the entertainment industry and the company's estimated earnings growth, we are positive on the stock. We, however, believe that at Rs183, the stock is priced fairly; hence, we initiate coverage on ILL with a 'HOLD' recommendation.

Inox Leisure Limited

Financials

Profit & Loss

Rs mn	FY05	FY06	FY07E	FY08E
Net sales	605.6	1,020.7	1,746.1	2,346.1
YoY (%)	110.0	68.6	71.1	34.4
Total expenses	389.1	660.7	1,149.0	1,557.7
Inc/dec in stock	0.0	0.0	(5.5)	(2.0)
Film distributor share	130.4	211.4	336.0	456.0
Staff cost	55.7	76.5	130.8	175.7
F&B cost	34.7	54.1	95.5	131.0
Operating & admn cost	168.3	318.7	592.2	796.9
Other expenses	0.0	0.0	0.0	0.0
EBIDTA	216.4	360.0	597.2	788.4
YoY (%)	118.8	66.4	65.9	32.0
EBIDTA (%)	35.7	35.3	34.2	33.6
Other income	11.6	19.7	19.7	19.7
PBIDT	228.0	379.7	616.8	808.1
Interest	53.7	78.9	89.1	79.1
Gross profit	174.3	300.8	527.7	728.9
Depreciation	34.6	51.7	87.6	98.9
PBT and extra ordinary	139.7	249.1	440.1	630.0
Extra ordinary items	(0.1)	0.0	0.0	0.0
PBT	139.6	249.1	440.1	630.0
(-) Tax	58.8	73.6	130.1	186.2
Tax/ PBT	42.1	29.5	29.5	29.5
PAT	80.8	175.5	310.1	443.9
Adjusted net profit	80.8	175.5	310.1	443.9
YoY (%)	218.5	117.1	76.7	43.1

Balance Sheet

Rs mn	FY05	FY06	FY07E	FY08E
Equity capital	450.0	600.0	600.0	600.0
Preference capital	0.0	0.0	0.0	0.0
Reserves	140.3	1,557.9	1,868.0	2,311.8
Net worth	590.3	2,157.9	2,468.0	2,911.8
Total borrowings	967.6	1,089.3	864.3	864.3
Deferred tax	66.3	107.7	180.8	285.5
Total liabilities	1,624.2	3,354.8	3,513.1	4,061.6
Gross block	1,524.7	1,821.7	2,963.9	3,368.9
Less: Acc. depreciation	69.9	120.8	208.4	307.4
Net block	1,454.8	1,700.8	2,755.5	3,061.5
CWIP	48.4	54.0	185.0	200.0
Investments	5.0	1,452.1	556.8	876.1
Current assets	269.0	385.7	347.5	364.3
Inventories	3.5	4.8	8.1	10.9
Debtors	18.4	25.3	40.7	54.6
Cash	15.7	30.3	20.0	20.0
Loans and advances	231.5	325.3	278.8	278.8
Current liabilities	147.6	228.6	303.2	406.9
Provisions	5.4	9.2	28.5	33.5
Net current assets	116.0	147.9	15.8	(76.0)
Miscellaneous expenses	0.0	0.0	0.0	0.0
Total assets	1,624.2	3,354.8	3,513.1	4,061.6

Key Ratios

	FY05	FY06	FY07E	FY08E
EPS (Rs)	1.8	2.9	5.2	7.4
Adjusted EPS (Rs)	0.0	0.0	0.0	0.0
CEPS (Rs)	3.6	4.5	7.8	10.8
Book value (Rs)	13.1	36.0	41.1	48.5
Dividend per share (Rs)	0.0	0.0	0.0	0.0
Debt-equity (x)	1.6	0.5	0.4	0.3
ROCE	11.7	9.5	15.3	18.3
ROE	13.7	8.1	12.6	15.2
Valuations				
PE (x)	101.7	62.5	35.4	24.7
Cash PE (x)	50.5	40.8	23.3	16.9
Price/book value (x)	13.9	5.1	4.4	3.8
Dividend yield	0.0	0.0	0.0	0.0
Market cap/sales	13.6	10.7	6.3	4.7
EV/sales (x)	15.1	11.8	6.8	5.0
EV/EBDITA (x)	42.4	33.4	19.8	15.0

Cash Flow

Rs mn	FY05	FY06	FY07E	FY08E
Net profit	80.8	175.5	310.1	443.9
Depn and w/o	34.6	51.7	87.6	98.9
Deferred tax	47.3	41.4	73.1	104.7
Change in working cap	(49.5)	(17.3)	121.8	91.9
Other income	11.6	19.7	19.7	19.7
Operating cash flow	124.7	271.0	612.3	759.0
Other income	(11.6)	(19.7)	(19.7)	(19.7)
Capex	(244.4)	(303.5)	(1,273.1)	(420.0)
Investments	0.0	(1,447.1)	895.3	(319.4)
Investing cash flow	(255.9)	(1,770.2)	(397.6)	(759.0)
Dividend	0.0	0.0	0.0	0.0
Fresh equity	(8.6)	1,276.5	0.0	0.0
Debt	122.2	121.7	(225.0)	0.0
Financing cash flow	113.7	1,398.2	(225.0)	0.0
Others	2.8	115.6	0.0	0.0
Net change in cash	(14.7)	14.6	(10.3)	(0.0)
Opening cash	30.4	15.7	30.3	20.0
Closing cash	15.7	30.3	20.0	20.0

Entertainment

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Spreading the Multiplex Magic

PVR Limited (PVR) is one of India's leading multiplex operators, running 20 multiplexes with 79 screens across India. By the end of FY08E, PVR intends to increase its multiplexes to 36, with 160 screens across 20 cities. If successfully executed, PVR's expansion plans would strengthen its market presence significantly, and would reinforce its image as a preferred anchor tenant among mall owners.

At the current market price of Rs234, the stock is trading at 43.9x FY07 PER and 17.7x FY08 PER. We expect the company's earnings to register a 140% CAGR during FY06-08E. We believe that the stock may outperform the index in the long term, given PVR's expansion plans and the increasing demand for multiplexes as an entertainment option. Hence, we recommend a 'Buy' on the stock.

- **Aggressive expansion plans:** By the end of 2008, PVR plans to increase its multiplexes, from the current 20 to 36. The planned expansion would increase the number of screens from current 79 to 160 by FY08E, and to 240 by FY09E.
- **Robust growth in revenues and operating margins anticipated:** PVR's revenues are expected to register an 81% CAGR growth between FY06-08E, supported by its expansion plans. Revenues are expected to increase by 74% in FY07E to Rs1827mn, and 89% in FY08E to Rs3456mn.
- **Preferred anchor tenant among mall owners:** PVR, the first entrant in the multiplex space, has emerged as one of the preferred anchor tenants among mall owners due to its ability to consistently increase the number of footfalls.
- **Expansion in EBITDA margins:** PVR's EBITDA margins are likely to expand significantly over the next two years due to the availability of entertainment tax exemption on 17 of its new 23 multiplexes.

Buy

Rs234

November 15, 2006

Market cap
Rs bn 5.4
US$ mn 119

Avg 3m daily volume
40,431

Avg 3m daily value
Rs mn 10.2

Shares outstanding (mn)
23

Reuters
PVRL.BO/PVR.NS

Bloomberg
PVR IN

Sensex
13,469

Nifty
3,876

Shareholding (%)

Promoters	40.5
FII's	29.0
MFs	22.8
Others	7.7

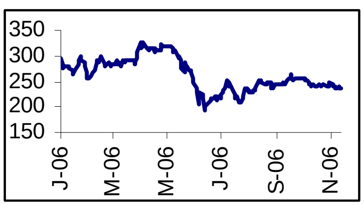
Share price performance

52-week high/low (Rs) 344/188

	-1m	-3m	-12m
Abs (%)	-3.6	-6.0	na
Rel* (%)	-7.7	-21.5	na

*to Nifty

Stock chart



Year-end	Sales	YoY	EBITDA	YoY	NP	EPS	YoY	PE	EV/EBITDA	PSR	PBR	RoE	RoCE	DPS	Div Yield
March	(Rs m)	(%)	(Rs m)	(%)	(Rs m)	(Rs)	(%)	(x)	(x)	(x)	(x)	(%)	(%)	(Rs)	(%)
FY2005	683	-	108	-	38	2	-	106	41	6	7.6	7.2	5.3	-	-
FY2006	1,049	54	158	47	53	2	4	102	35	5	3.1	3.1	3.0	1.4	0.6
FY2007E	1,827	74	362	128	122	5	132	44	17	3	3.0	6.7	8.4	1.6	0.7
FY2008E	3,456	89	803	122	303	13	148	18	9	2	2.6	14.6	14.3	1.6	0.7

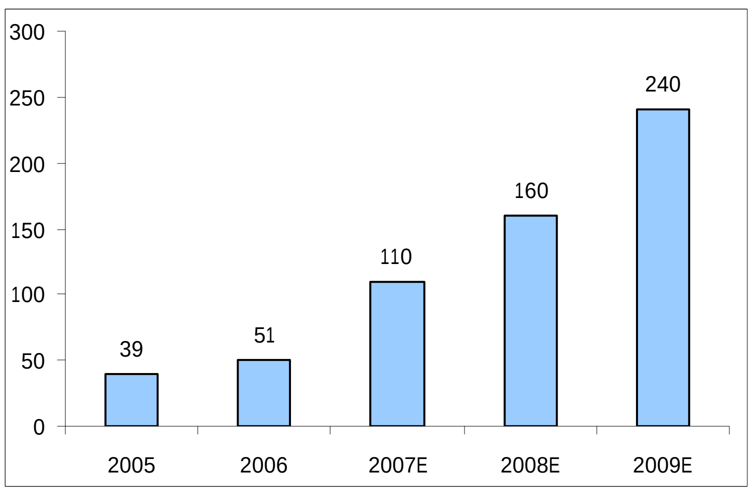
PVR Limited

Investment rationale

PVR intends to add 16 multiplexes by 2008, increasing its total multiplexes to 36. The company intends to fund these acquisitions through a mix of debt and internal accruals.

- **Aggressive expansion plans:** By end of 2008, PVR plans to increase its number of multiplexes from the current 20 to 36. The planned expansion would increase the number of screens from current 79 to 160 by FY08E and to 240 by FY09E (see chart 12). The company intends to set up its multiplexes in Maharashtra, Uttar Pradesh, Punjab, Madhya Pradesh, and the Delhi region. Within Maharashtra, PVR is likely to set up five multiplexes with more than 25 screens in Mumbai; the company has already set up two 'no frills', three-screen, multiplexes one each in Aurangabad and Latur. Almost all the new multiplexes are likely to be a part of some mall, given the higher number of potential footfalls in this infrastructure set up; no standalone multiplexes are likely to be opened. PVR is likely to incur Rs2.5bn for executing its expansion plans. The company has already raised Rs.1225mn through an IPO; PVR intends to fund the balance through a mix of debt and internal accruals. We believe that PVR's expansion plans, if executed successfully, would significantly boost its market presence and enhance its financial profile.

Chart 12. Projects signed till June 2006 (number of screens)



Source: IISL research, company

PVR's expansion plans would strengthen its presence in 20 towns across the country, making it a pan-India player.

- **Pan-India presence:** With the execution of the proposed expansion plan, PVR would be able to make itself a pan-India player. Currently, PVR is present in Tier I cities such as Delhi, Bangalore, Mumbai, Lucknow, and Hyderabad. The company has entered Tier II cities such as Aurangabad and Latur that offer huge potential for growth. PVR is likely to expand its presence in 20 towns across India by the end of FY08E. Table 13 and 14 outline PVR's existing and upcoming projects.

Table 13. Existing Multiplexes

	Location	Screens	Seats
Anupam	Delhi	4	1,000
Priya	Delhi	1	944
Naraina	Delhi	4	830
Vikaspuri	Delhi	3	921
Gurgaon	Gurgaon, Haryana	7	1,310
Plaza	Delhi	1	300
Faridabad	Faridabad, Haryana	2	504
Bangalore	Bangalore	11	2,011
EDM	Delhi	3	720
Hyderabad	Hyderabad	3	926
Spice PVR	UP, Noida	8	1,821
Mulund	Mulund	6	1,821
Rivoli	Rivoli	1	329
Indore	Indore, MP	5	1,199
Sahara Lucknow	Sahara Lucknow	4	874
Juhu	Juhu	5	1,260
SRS PVR	Faridabad	3	776
Sahara Gurgaon	Sahara Gurgaon	2	528
Aurangabad	Aurangabad	3	1,156
Latur	Maharashtra	3	1,136
Total		**79**	**18,074**

Source: IISL research, company

Table 14. Upcoming multiplexes

	Location	Screens	Seats
Prashant Vihar	Delhi	3	818
Goregaon	Goregaon	6	1,800
DDA Saket Place	DDA Saket Place	6	1,269
Phoenix, Mumbai	Mumbai	7	2,050
Chennai	Chennai	7	1,600
Malhar	Ludhiana	4	1,025
Gurgaon	Haryana	7	1,500
Ghatkopar, Mumbai	Maharashtra	4	1,250
Rajouri Garden	Rajouri Garden	6	1,500
Freemans Mall	Ludhiana	3	1,050
Moradabad	Moradabad	4	873
Amritsar	Amritsar	5	1,100
Jalandhar	Jalandhar	4	1,300
Bhatinda	Bhatinda	4	1,025
Hazrat Ganj	Lucknow	4	1,037
Chandigarh	Chandigarh	4	1,013
Panipat	Panipat	3	800
Viraj Khand	Lucknow	3	740
Jaipur	Rajasthan	5	1,067
Bangalore	Karnatka	12	2,800
Amritsar 2	Punjab	4	1,000
Khanna	Punjab	4	1,200

PVR Limited

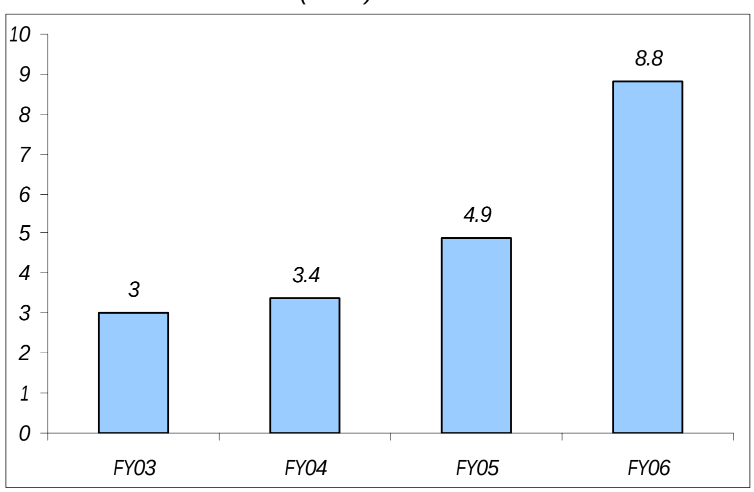
Jalandhar 2	Punjab	4	1,200
Ranchi	Jharkhand	6	1,250
Dhanbad	Jharkhand	4	1,000
Dehradun 1	Uttranchal	5	1,250
Ahemdabad 1	Gujarat	6	1,500
Mysore	Karnatka	6	2,235
Ahemdabad 2	Gujarat	7	1,300
Coimbatore	Tamil Nadu	6	2,033
Vijaywada	Andhra Pradesh	4	1,230
Raipur	Chhatisgarh	4	1,400
Amritsar 3	Punjab	4	1,250
Dehradun 2	Uttranchal	6	1,500
Total		171	44,965

Source: IISL research, company

PVR's status as a preferred anchor tenant can be attributed to its first mover advantage in the multiplex space.

- **Preferred anchor tenant by mall owners:** On an average, multiplexes generate about 40-50% of the footfalls for a retail mall. PVR has leveraged on its first mover advantage in the multiplex space to emerge as one of the preferred anchor tenants among mall owners. Chart 13 and 14 depict the increasing number of patrons and occupancy rates in PVR cinemas that have led to higher footfalls.

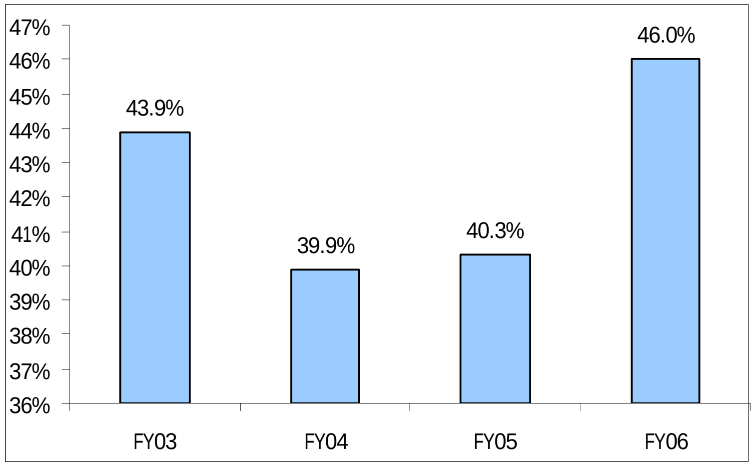
Chart 13. Number of Patrons (in mn)



Source: IISL research, company

PVR Limited

Chart 14: Occupancy Rate (in %)



Source: IISL research, company

Robust growth in revenues and operating margins anticipated:

PVR's revenues are likely to increase by 81% CAGR during the next two years.

PVR's revenues are expected to register an 81% CAGR growth between FY06-08E, supported by its expansion plans. Revenues are expected to increase by 74% in FY07E to Rs1827mn, and 89% in FY08E to Rs3456mn. The increase in realizations is also likely to be supported by entertainment tax exemptions in PVR's 17 out of 23 new multiplexes. Consequently, operating margins are expected to improve from 15.1% in FY06 to 23.2% in FY08E (see chart 16).

PVR Limited

Background

Over the past nine years, PVR has emerged as an integrated film exhibition and distribution company, operating 18 multiplexes under the PVR brand.

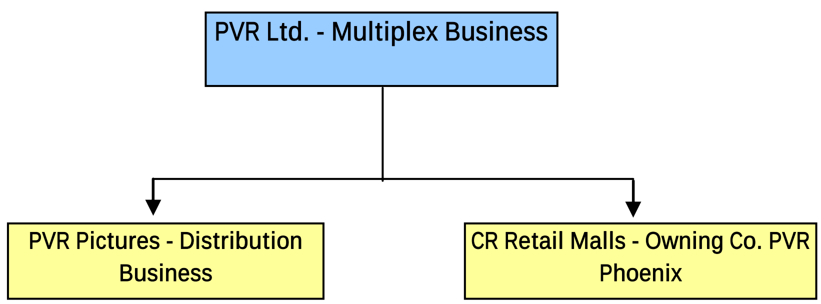
PVR was incorporated in 1995 through a joint venture agreement between Priya Exhibitors Private Limited and the Australia-based Village Roadshow Limited, one of the world's largest non-U.S. cinema exhibition companies with more than 1,000 screens under operation. Village Roadshow's international experience facilitated the launch of PVR's first multiplex cinema in India at New Delhi. The company has also designed PVR's 11-screen multiplex cinema at Bangalore (Karnataka) and assisted PVR in launching few other multiplexes.

Over the past nine years, PVR has emerged as an integrated film exhibition and distribution company, operating 18 multiplexes under the *PVR* brand. In 1997, the company established PVR Anupam, in Saket, Delhi, the first multiplex cinema in India; in 2004, PVR set up the largest multiplex cinema (11 screens) in India at Bangalore.

Subsidiaries

PVR has two wholly owned subsidiaries, PVR pictures and C R Retail (see chart 15).

Chart 15. PVR Cinema - Corporate Structure



Source: IISL research, company

- **PVR Pictures:** PVR Pictures a movie distribution company. The company distributes Hindi films in cities where its multiplexes are located. For international films, PVR Pictures purchases the entire gamut of distribution rights including theatrical, satellite/television, and DVD rights. PVR has invested Rs.20mn in this company.
- **C R Retail:** PVR is developing a seven-screen multiplex in the Phoenix Mills compound, a key retail, commercial, and entertainment hub in Lower Parel, Mumbai. The project is being executed by CR Retail. We believe that Phoenix Mills, when fully developed, may emerge as one of the largest retail destinations in Mumbai. The multiplex will have a capacity of 2,050 seats and is expected to be operational by fiscal 2007.The total estimated cost of this project is Rs720mn.

PVR Limited

Financial Profile

PVR's six new multiplexes that became operational during FY05 and FY06 contributed to a revenue growth of 54% YoY in FY06. During H1FY07, the company PVR's net sales and net profits increased by 54.5% YoY and 73.3% respectively.

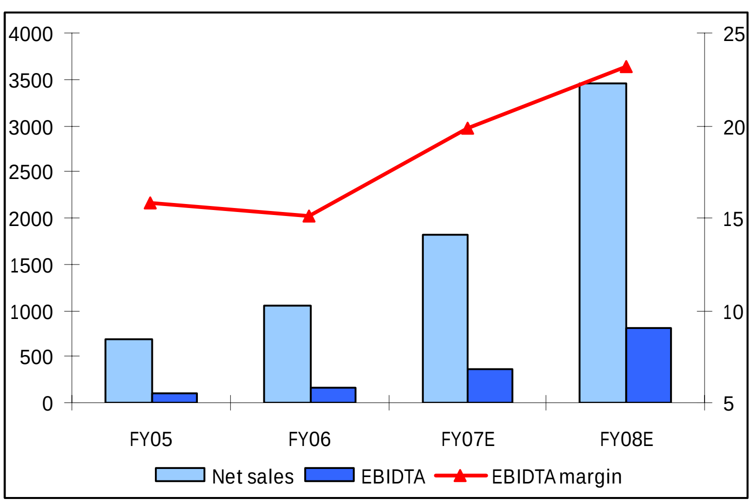
On a consolidated basis, for FY06, PVR recorded a revenue growth of 54% YoY to Rs1049mn. This growth was mainly driven by the company's six new multiplexes that became operational during FY05 and FY06. Moreover, during FY06, PVR's occupancy rate increased to 46% as against 40.3% for FY05. This also contributed to the increase in revenues.

For FY06, PVR's EBITDA increased 47% to Rs158.5mn, up from Rs108mn in FY05. However, its EBITDA margins fell 70bps, from 15.8% in FY05 to 15.1% in FY06. At the net profit level, PVR reported a growth of 40% YoY to Rs53mn in FY06, up from Rs38mn in FY05.

For H1FY07, PVR reported net sales and net profits of Rs839mn and Rs67mn, an increase of 54.5%YoY and 73.3%YoY, respectively. This increase was driven by the addition of nine new multiplexes during the year and like-to-like growth in the existing multiplexes. The company's EBITDA, however, grew only 28.5% as the other expenditure increased by 95% due to launch of new multiplexes. PVR's EBITDA margins declined 310bps to 15.6% for H1FY07 as against 18.7% in H1FY06. PVR's net profit increased 73% to Rs67mn in H1FY07; this increase was due to a 319% increase in the company's other income that primarily included interest and dividend income. PVR's net profit margins increased 90bps to 8% as against 7.1% in the corresponding period the previous year.

During FY06-08E, we expect PVR's revenues and net profits to grow by 81% and 140% CAGR respectively, contingent on the successful execution of its expansion plans. Moreover, with the availability of entertainment tax exemptions on 17 of its 23 new properties, we expect the company's EBITDA margins to expand to 19.8% in FY07E and 23.2% in FY08E.

Chart 16. Financial Performance (Rs mn)



Source: IISL research, company

PVR Limited

Valuations

Given the strong, anticipated growth in PVR's financial performance, and robust growth prospects of the movie exhibition segment, we recommend a 'Buy' on the stock.

We estimate PVR's revenues to grow at an 81% CAGR over the next two years; this growth will be driven by the launch of PVR's upcoming multiplexes. Exemption of entertainment tax in almost all the new upcoming multiplexes will also contribute to the increase in revenues. Consequently, PVR's EBITDA margins are expected to expand to 19.8% in FY07E and 23.2% in FY08E.

After being present in the North India for about seven years, PVR has expanded its presence in Southern and Western India during the past two years. We believe that the company's strong and capable management should enable it to strengthen its presence in the domestic market.

Currently, the stock is trading at a P/E of 43.9xFY07E and 17.7xFY08E earnings. Given the robust demand in the entertainment sector and the company's massive growth plans, we recommend a 'BUY' rating on the stock.

Financials

Profit & Loss

Rs mn	FY05	FY06	FY07E	FY08E
Net sales	683.0	1,049.1	1,826.6	3,455.8
YoY (%)	41.2	53.6	74.1	89.2
Total expenses	575.2	890.6	1,465.0	2,652.9
Distributor's cost	176.8	268.1	439.8	801.0
Food & Beverages	45.7	71.2	139.0	253.4
Staff cost	74.4	125.5	164.4	285.1
Power and fuel cost	0.0	0.0	0.0	0.0
Other manufacturing expe	0.0	0.0	0.0	0.0
Operating expenses	278.3	425.8	721.7	1,313.4
EBIDTA	107.8	158.5	361.6	802.8
YoY (%)	63.4	47.0	128.2	122.0
EBIDTA (%)	15.8	15.1	19.8	23.2
Other income	24.2	43.0	24.8	24.8
PBIDT	132.0	201.5	386.4	827.6
Interest	23.9	30.7	64.5	117.4
Gross profit	108.2	170.8	321.9	710.2
Depreciation	55.2	83.3	122.3	214.0
PBT and extra ordinary	53.0	87.4	199.6	496.2
Extra ordinary items	0.0	0.0	0.0	0.0
PBT	53.0	87.4	199.6	496.2
(-) Tax	15.3	34.8	77.4	193.5
Tax/ PBT	28.8	39.8	38.8	39.0
PAT	37.7	52.7	122.2	302.7
Adjusted net profit	37.7	52.7	122.2	302.7
YoY (%)	142.6	39.6	132.0	147.7

Balance Sheet

Rs mn	FY05	FY06	FY07E	FY08E
Equity capital	171.0	228.8	228.8	228.8
Preference shares	0.0	200.0	200.0	200.0
Reserves	356.3	1,498.0	1,583.4	1,850.5
Net worth	527.3	1,726.8	1,812.2	2,079.3
Total borrowings	468.0	816.1	1,032.5	2,032.2
Deferred tax	42.3	45.8	83.5	153.0
Total liabilities	1,037.6	2,588.7	2,928.3	4,264.5
Gross block	830.5	1,011.6	1,961.3	3,402.2
Less: Acc. depreciation	159.6	227.9	350.3	564.3
Net block	670.9	783.6	1,611.0	2,838.0
CWIP	178.2	822.1	1,000.0	1,200.0
Investments	12.0	294.2	12.0	12.0
Current assets	332.6	999.0	696.8	754.0
Inventories	6.8	9.2	15.2	27.6
Debtors	24.6	44.6	102.0	193.1
Cash	95.0	630.2	201.3	100.0
Loans and advances	206.2	315.0	378.3	433.3
Current liabilities	145.6	238.7	326.2	474.1
Provisions	10.6	71.6	65.4	65.4
Net current assets	176.5	688.7	305.2	214.5
Miscellaneous expenses	0.0	0.0	0.0	0.0
Total assets	1,037.6	2,588.7	2,928.3	4,264.5

Key Ratios

	FY05	FY06	FY07E	FY08E
EPS (Rs)	2.2	2.3	5.3	13.2
Adjusted EPS (Rs)	0.0	0.0	0.0	0.0
CEPS (Rs)	5.9	6.1	12.3	25.6
Book value (Rs)	30.8	75.5	79.2	90.9
Dividend per share (Rs)	0.0	1.4	1.6	1.6
Debt-equity (x)	0.9	0.5	0.6	1.0
ROCE	5.3	3.0	8.4	14.3
ROE	7.2	3.1	6.7	14.6
Valuations				
PE (x)	106.2	101.8	43.9	17.7
Cash PE (x)	39.9	38.4	19.1	9.1
Debt/Equity	0.9	0.5	0.6	1.0
Price/book value (x)	7.6	3.1	3.0	2.6
Dividend yield	0.0	0.6	0.7	0.7
Market cap/sales	5.9	5.1	2.9	1.6
EV/sales (x)	6.4	5.3	3.4	2.1
EV/EBDITA (x)	40.6	35.0	17.1	9.1

Cash Flow

Rs mn	FY05	FY06	FY07E	FY08E
Net profit	37.7	52.7	121.1	302.7
Depn and w/o	55.4	83.5	122.5	214.2
Deferred tax	7.7	3.5	37.7	69.5
Change in working cap	35.4	22.9	(45.4)	(10.6)
Other income	(24.2)	(43.0)	(24.8)	(24.8)
Operating cash flow	112.0	119.6	211.2	551.0
Other income	24.2	43.0	24.8	24.8
Capex	(418.6)	(840.0)	(1,127.6)	(1,641.0)
Investments	(7.0)	(282.2)	282.1	0.0
Investing cash flow	(401.4)	(1,079.1)	(820.7)	(1,616.2)
Dividend	0.0	(32.0)	(35.8)	(35.8)
Fresh equity	60.3	1,130.0	0.0	0.0
Debt	165.7	348.0	216.4	999.7
Financing cash flow	226.0	1,446.0	180.6	963.9
Others	132.2	48.7	0.0	0.0
Net change in cash	68.8	535.2	(428.9)	(101.3)
Opening cash	26.2	95.0	630.2	201.3
Closing cash	95.0	630.2	201.3	100.0

IL&FS INVESTSMART
Institutional Equity

Entertainment

Shringar Cinemas Limited

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Expansion to turnaround operations: 'Buy' Recommended

Shringar Cinemas Limited (Shringar) is one of the oldest players in the Indian movie distribution and exhibition segment, currently operating seven multiplexes under the brand *Fame*. The company intends to add about eight multiplexes every year for the next three years; this will increase its total multiplexes to 39 by FY09E. Shringar's proposed expansion plans, if successfully executed, would make it one of the largest players in the Indian movie exhibition sector.

Shringar's revenues are expected to register a 71% CAGR between FY06-08E, with an expected FY07E EPS of Rs2.3 and FY08E EPS of Rs4.6. Currently, the stock is trading at 24.7xFY07E and 13.3xFY08E earnings; we believe that the stock may outperform the index due to the anticipated growth in the company's revenues. Hence, we recommend a 'Buy' rating on the stock.

- Aggressive expansion plans - robust financial growth anticipated: In the next few years, Shringar intends to establish itself as a pan-India player by adding 7-8 properties every year. If successfully executed, this expansion plan will increase the screens operated by Shringar from the current 31 to 169 in FY09E. We expect the company's financial profile to turnaround in FY07E, with revenues and net profits jumping by 71% and 168% during FY06-08E, respectively.
- Entertainment tax exemptions to enhance EBITDA margins: About 70% of the new properties signed by Shringar are likely to be exempt from entertainment tax, increasing total sales by 30% in FY08E. Consequently, EBITDA margins are likely to expand from 9.2% in FY06 to 24.2% in FY08E.
- Increased focus on Tier II cities: Shringar intends to explore movie exhibition opportunities in the Tier II cities such as Ambala, Amritsar, Panchkula, Aurangabad, Mysore, and Kundli.

Buy

Rs57

November 15, 2006

Market cap	Rs bn 1.8 US$ mn 40
Avg 3m daily volume	45,990
Avg 3m daily value	Rs mn 2.7
Shares outstanding (mn)	32
Reuters	SHRC.BO/SHRINGAR.NS
Bloomberg	SC IN
Sensex	13,469
Nifty	3,876

Shareholding (%)

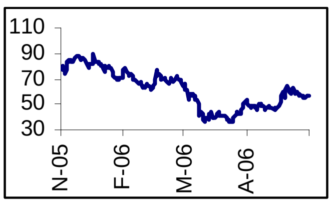
Promoters	*47.8*
FII's	*11.1*
MFs	*3.2*
Others	*37.9*

Share price performance

52-week high/low (Rs)	93/33		
	-1m	-3m	-12m
Abs (%)	-7.1	6.2	-27.0
Rel* (%)	-11.2	-9.4	-77.1

*to Nifty

Stock chart



Year-end	Sales	YoY	EBITDA	YoY	NP	EPS	YoY	PE	EV/EBITDA	PSR	PBR	RoE	RoCE	DPS	Div Yield
March	(Rs m)	(%)	(Rs m)	(%)	(Rs m)	(Rs)	(%)	(x)	(x)	(x)	(x)	(%)	(%)	(Rs)	(%)
FY2005	379	-	34	-	-35	-	-	-	51	4	7.5	(19.6)	(0.3)	-	-
FY2006	580	53	53	57	-29	-	-	-	36	3	3.0	(3.2)	1.9	-	-
FY2007E	900	55	179	237	63	2	-	25	15	2	2.7	10.9	6.1	-	-
FY2008E	1,700	89	388	117	135	5	99	13	7	1	2.2	17.9	12.1	-	-

Shringar Cinemas Limited

Investment Rationale

During the next few years, Shringar intends to add 7-8 properties every year. This will increase the number of screens operated by the company from the current 31 to 169 in FY07E.

- **Aggressive expansion plans - robust financial growth anticipated:** In the next few years, Shringar intends to establish itself as a pan-India player by adding 7-8 properties every year. The company's expansion plans are divided into two phases. Under Phase I, Shringar intends to focus on metropolitan cities by setting up new multiplexes and entering into management contracts in these cities. Phase II of the expansion plan will target smaller towns and cities; under this phase, the company is also likely to branch into single- screens to target different demographic segments. Table 1 and 2 outline the company's existing and proposed multiplexes.

  Shringar has already signed 33 properties across India to set up multiplexes during the next three years. The company has also raised USD20mn through a FCCB issue to fund its expansion plans. Apart from this, the company is also likely to raise debt as and when needed. If successfully executed, this expansion plan will increase the number of screens operated by Shringar from the current 31 to 169 in FY09E. We expect the company's financial profile to turnaround in FY07E, with revenues and net profits jumping by 71% and 168% during FY06-08E, respectively. We believe that better economies of scale would reduce operational costs, supporting the growth in profit margins.

Table 15. Existing multiplexes

Multiplex	Screens	Seats
Fame Adlabs	5	1,342
Fame Malad	6	1,571
Fame Nasik	3	1,407
Fame Kandivili	4	1,275
Fame Kolkata	4	897
Fame Pune	3	1,009
Fame Surat	6	1,950
Mumbai	1	282
Total	**32**	**9733**

Source: IISL research, company

Table 16. Upcoming multiplexes

Multiplex	Screens	Seats
Chandigarh	3	600
Allahabad	4	1,120
Aurangabad	3	1,040
Pune	3	1,010
Kolkata	6	1,450
Bangalore	5	1,200
Mumbai	5	1,505
Mumbai	5	1,361

Punjab	4	1,000
Bangalore	4	1,080
Punjab	5	940
Punjab	4	1,050
Hyderabad	3	812
Delhi	3	950
Punjab	5	1,041
Mumbai	4	1,075
Chennai	6	1,400
Mumbai	4	1,250
Mumbai	3	1,000
Pune	3	1,000
Kolkatta	5	1,200
Bangalore	4	1,100
Mumbai	5	1,250
Kolkatta	4	1,200
Punjab	3	800
Punjab	4	1,000
Punjab	12	2,000
Haryana	4	1,233
UP	6	1,800
Pune	5	1,400
Pune	3	1,250
Total	**137**	**36,117**

Source: IISL research, company

About 70% of Shringar's new properties are likely to enjoy entertainment tax exemptions, increasing total sales by 30% in FY08E

- **Entertainment tax exemptions to support financial profile:** Shringar has adopted a strategy of expanding into states with low or no entertainment tax. About 70% of the new properties signed by the company are likely to enjoy the benefits of entertainment tax exemptions, increasing total sales by 30% in FY08E. Consequently, the company's EBITDA margins are expected to expand from 9.2% in FY06 to 24.2% in FY08E.

Shringar launched its first food court in Surat (Gujarat) in September 2006.

- **Foray into the high-margin food court business:** In FY07E, Shringar plans to enter the high-margin food court business through its 100% subsidiary, Oxford Multiplex Cinemas, via *1 Food Street.* Initially, the company is likely to set up a chain of food courts in its own multiplexes; in the longer term, Shringar may open standalone outlets in other malls outside *Fame* multiplexes. We believe that entering into the food court business may enhance the company's earnings, going forward. However, revenues from this business have not been considered in our projections and valuations, as the business is still in its initial stages (the company launched its first Food Court in Surat in September 2006).

Shringar plans to enter Tier II cities such as Ambala, Amritsar, and Panchkula that are likely to offer stronger growth than metros, going forward.

- **Increased focus on Tier II cities:** Shringar intends to explore movie exhibition opportunities in the Tier II cities such as Ambala, Amritsar, Panchkula, Aurangabad, Mysore, and Kundli; these cities are expected to show relatively stronger growth than metros, going forward. In line with this strategy, Shringar plans to reduce its exposure to the distribution business. Expansion into Tier II cities, besides enhancing the company's geographical presence, will add significantly to its revenue base.

Based on the company's strong, anticipated growth in its financial profile, and the robust growth prospects of the movie exhibition segment, we recommend a 'Buy' on the stock.

- Valuations: Shringar's expansion plans, if successfully executed, will strengthen its competitive position in the fast-growing movie exhibition segment. We believe that the company's strategy of shifting focus from movie distribution to movie exhibition, especially in Tier II cities, would entail significant benefits in the longer term. Shringar's financial profile is likely to turnaround, with revenues and profits expected to register robust growth over the next few years. Hence, we recommend a 'Buy' rating on the stock.

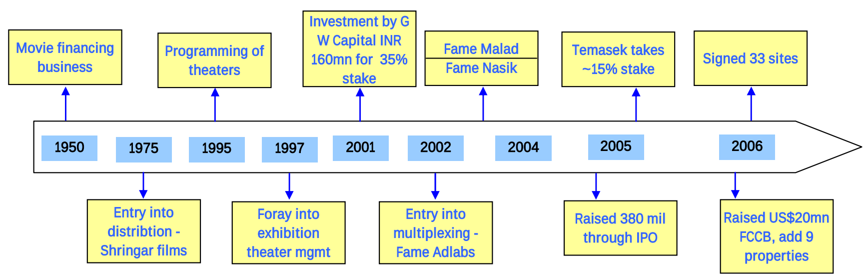
Shringar Cinemas Limited

Background

Over the last 20 years, Shringar has grown from a movie finance company to one of the leading players in the movie exhibition space.

The Shroff family, with more than 25 years of experience in the movie distribution business, promoted Shringar in 1975. Shringar commenced operations in the 1950s as a movie financing company, then known as Issardas Naoomal. In the 1960s, the company entered into the distribution business that it carried out through its 100% subsidiary, Shringar Films Private Limited. Shringar has leveraged on its experience in this business segment to enter into the movie exhibition segment in the late 1990s. Chart 17 depicts Shringar's growth story. Currently, the company operates eight multiplexes in Mumbai, Nasik, Surat and Kolkata, under the brand name *Fame*. The company has formed a 50% joint venture with Adlabs films under the name Swanston Multiplex that operates Fame Adlabs in Andheri, Mumbai.

Chart 17. Growth story



Source: IISL research, company

Shringar follows a unique promotional strategy to increase the number of footfalls in its multiplexes. For instance, it has tied by with companies such as UTI Bank, SBI Credit Cards Limited, and Hutch for offering free tickets and tickets at discounted prices. Shringar also plays extra shows to accommodate block bookings by large corporates. The company also sells ticket booklets to secure repeat audiences.

Shringar intends to reduce its focus on the movie distribution segment; the business contributed 28% to the company's revenues in FY06.

- **Distribution as a support business**: Shringar is a backward integrated company with a presence in film distribution. So far, the company has distributed Hindi movies, dubbed movies, regional movies, and movies under the Paramount India tie-up. Some of the movies distributed by Shringar include *Malamaal Weekly*, *Garam Masala*, *Choker Bali*, and *Anniyan*. The distribution business contributed 28% to the company's total revenues in FY06. Going forward, Shringar intends to reduce its focus on the distribution business; the exhibition business is likely to remain as the growth driver for the company. Shringar would be investing around Rs3.3bn for setting up 34 multiplexes with 147 screens across India in the next few years. For this expansion, company would utilize money raised through the IPO and the FCCB issues. The USD 20 million FCCB issue comprises USD12 million zero coupon series 'A' unsecured bonds due in 2011, and USD 8 million 0.5% per annum series 'B' unsecured bonds due in 2011; the yield to maturity (YTM) for series

'A' and series 'B' bonds shall be 6.5% and 7.5%, respectively. The company is also likely to raise debt as and when required.

Financial Profile

In FY06, Shringar's revenues increased by 53% YoY to Rs. 580mn. During H1FY07, the company recorded a 59% YoY growth in revenues.

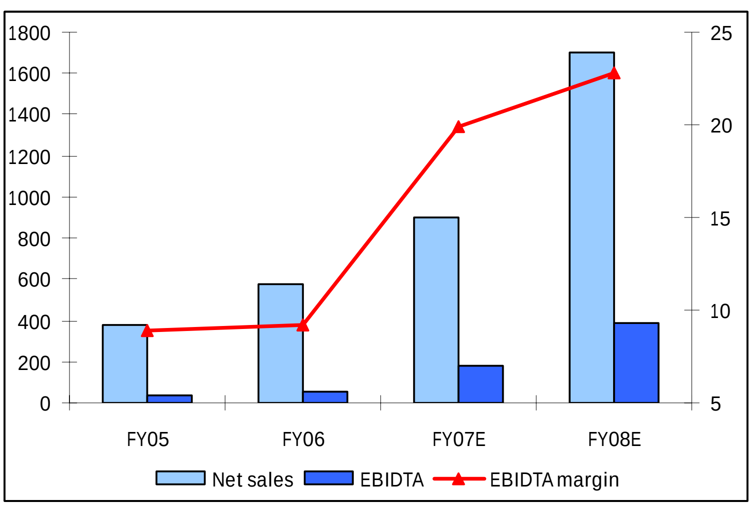
On a consolidated basis, Shringar recorded a revenue growth of 53%YoY to Rs580mn in FY06. This growth was mainly driven by a 52%YoY growth in the movie exhibition segment that contributed more than 70% to the company's topline. Shringar's movie distribution segment grew 56%YoY, contributing 28% to the consolidated revenues in FY06.

Strong revenue growth increased Shringar's EBITDA levels 53%YoY to Rs53.1mn; EBITDA margins increased marginally by 30bps to 9.2% in FY06. However, at a net level, the company reported a loss of (Rs29mn) in FY06 as against a loss of (Rs51.9mn) in FY05. This was mainly due to higher corporate expenses incurred for the launch of its new multiplexes.

For H1FY07, company reported net sales of Rs231mn as against Rs145mn in H1FY06, an increase of 59%YoY. Shringar's EBITDA increased 218% to Rs31mn from Rs9.7mn in H1FY06; EBITDA margins increased from 6.7% to 13.4% in H1FY07. The company made a net profit of Rs39mn in H1FY07 as against a loss of Rs15mn in the corresponding period last year.

Going forward, we expect Shringar to turnaround in FY07E. The company is expected to report a net profit of Rs27mn in FY07E and Rs125mn in FY08E. Its EBITDA margins are expected to increase to 24% in FY08E from 9.2% in FY06. Chart 2 depicts Shringar's financial performance during FY05-FY08E.

Chart 18. Financial Performance (Rs. mn)



Source: IISL research, company

Shringar Cinemas Limited

Valuations

Shringar is quoting at 24.7xFY07E and 13.3xFY08E PER. Given the robust, anticipated growth in the company's financial performance, we recommend a 'Buy' on the stock.

Currently, Shringar is quoting at 24.7xFY07E and 13.3xFY08E PER. Shringar's expansion plans, if successfully executed, will strengthen its competitive position in the fast-growing movie exhibition segment. Shringar's financial profile is likely to turnaround, with revenues and profits expected to register robust growth over the next few years. Hence, we recommend a 'Buy' rating on the stock.

Shringar Cinemas Limited

Financials

Profit & Loss

Rs mn	FY05	FY06	FY07E	FY08E
Net sales	378.6	580.1	899.9	1,700.1
YoY (%)		53.2	55.1	88.9
Total expenses	344.8	527.0	720.9	1,312.5
Direct Cost	159.9	254.0	308.0	540.9
Programming cost	0.0	0.0	0.0	0.0
Staff cost	42.6	68.9	90.0	153.0
F & B	0.0	0.0	0.0	0.0
Exhibition cost	0.0	0.0	0.0	0.0
Operating expenses	142.3	204.2	322.9	618.5
EBIDTA	33.8	53.1	178.9	387.6
YoY (%)		57.1	237.1	116.6
EBIDTA (%)	8.9	9.2	19.9	22.8
Other income	11.4	33.6	57.9	29.9
PBIDT	45.2	86.7	236.8	417.5
Interest	23.5	57.1	58.7	61.6
Gross profit	21.7	29.5	178.1	355.8
Depreciation	35.6	36.0	69.6	139.5
PBT and extra ordinary	(13.9)	(6.5)	108.5	216.3
Extra ordinary items	0.0	0.0	0.0	0.0
PBT	(13.9)	(6.5)	108.5	216.3
(-) Tax	21.1	12.4	35.8	71.4
Tax/ PBT	(151.6)	(189.4)	33.0	33.0
PAT	(35.0)	(18.9)	72.7	144.9
Adjusted net profit	(35.0)	(29.0)	62.6	134.8
YoY (%)	(262.4)	(17.1)	316.1	115.4

Balance sheet

Rs mn	FY05	FY06	FY07E	FY08E
Equity capital	234.2	315.7	315.7	315.7
Preference shares	0.0	0.0	0.0	0.0
Reserves	(55.8)	275.8	348.5	493.4
Net worth	178.3	591.4	664.1	809.0
Total borrowings	404.9	287.2	1,140.0	1,241.7
Deferred tax	5.7	5.7	5.7	5.7
Total liabilities	588.9	884.3	1,809.8	2,056.4
Gross block	571.5	647.0	1,181.3	1,839.4
Less: Acc. depreciation	283.1	329.7	399.3	538.8
Net block	288.4	317.3	782.0	1,300.6
CWIP	95.7	150.0	150.0	150.0
Investments	25.4	178.1	578.7	298.5
Current assets	349.3	435.4	459.9	525.7
Inventories	0.6	0.9	1.1	1.9
Debtors	30.7	48.8	73.1	138.1
Cash	29.1	200.0	200.0	200.0
Loans and advances	288.9	185.7	185.7	185.7
Current liabilities	112.5	139.2	103.5	161.2
Provisions	57.3	57.3	57.3	57.3
Net current assets	179.5	238.9	299.1	307.3
Miscellaneous expenses	0.0	0.0	0.0	0.0
Total assets	588.9	884.3	1,809.8	2,056.4

Key Ratios

	FY05	FY06	FY07E	FY08E
EPS (Rs)	(1.5)	(0.6)	2.3	4.6
Adjusted EPS (Rs)	0.0	(0.9)	2.0	4.3
CEPS (Rs)	(0.7)	0.5	4.5	9.0
Book value (Rs)	7.6	18.7	21.0	25.6
Dividend per share (Rs)	0.0	0.0	0.0	0.0
Debt-equity (x)	2.3	0.5	1.7	1.5
ROCE	(0.3)	1.9	6.1	12.1
ROE	(19.6)	(3.2)	10.9	17.9
Valuations				
PE (x)	(38.2)	(95.3)	24.7	13.3
Cash PE (x)	(86.0)	113.2	12.6	6.3
Debt/Equity	2.3	0.5	1.7	1.5
Price/book value (x)	7.5	3.0	2.7	2.2
Dividend yield	0.0	0.0	0.0	0.0
Market cap/sales	3.5	3.1	2.0	1.1
EV/sales (x)	4.5	3.2	3.0	1.7
EV/EBDITA (x)	50.6	35.5	15.3	7.3

Cash Flow

Rs mn	FY05	FY06	FY07E	FY08E
Net profit	(51.8)	(18.9)	72.7	144.9
Depn and w/o	35.6	36.0	69.6	139.5
Deferred tax	0.8	(1.3)	0.0	0.0
Change in working cap	(75.9)	111.5	(60.2)	(8.1)
Other income	(11.4)	(33.6)	(57.9)	(29.9)
Operating cash flow	(102.8)	93.9	24.2	246.5
Other income	11.4	33.6	57.9	29.9
Capex	(419.6)	(119.4)	(534.3)	(658.1)
Investments	(25.4)	(152.7)	(400.6)	280.1
Investing cash flow	(433.6)	(238.5)	(877.0)	(348.1)
Dividend	0.0	0.0	0.0	0.0
Fresh equity	(176.0)	431.9	0.0	0.0
Debt	283.7	(117.7)	852.8	101.6
Financing cash flow	107.7	314.3	852.8	101.6
Others	439.3	0.0	0.0	0.0
Net change in cash	10.6	169.6	(0.0)	(0.0)
Opening cash	18.5	29.1	200.0	200.0
Closing cash	29.1	200.0	200.0	200.0

Multiplex Magic

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