

PVR Ltd

A Bet on Increasing discretionary spending in India



Our key objective is to pick stocks which can compound sustainably at a healthy rate for the next 3-5 years and create wealth. We like to select companies with strong competitive advantages and are quoting at a discount to their intrinsic value.

*For more information on **PVR Ltd** and the opportunity in it, feel free to discuss with **Gokul Raj. P***

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PVR Ltd – Investment Snapshot (As on May 23, 2012)

Recommendation :- BUY

Accumulation Range :- 130-145

Current Market Price – Rs. 147.5

Bloomberg / Reuters Code – PVRL IN / PVRL.BO

BSE / NSE Code – 532689 / PVR

Mkt Cap (INR BN / USD Mn) – 3.83 / 68.39
[1 USD – Rs. 56.02]

Total Equity Shares [Mn]– 25.8

Face Value – Rs. 10

52 Week High / Low – Rs. 164 / Rs. 95

Promoter's Holding –44.80%

Institutional Holding – 21.49%

Priya Village Roadshow began its commercial operations in 1997, with the launch of PVR Anupham in Saket which is India's first multiplex.

Village Roadshow of Australia and Priya Exhibitors promoted by Bijli family decided to split in 2002, following VR's management decision to pull out of foreign countries.

In 2003, Renuka Ramnath of ICICI Ventures decided to back PVR with a Fund infusion of close to 40 Cr Rs considering the entrepreneurial energy of Bijli's.

PVR is today the face of the Multiplex revolution with its promoter Mr. Ajay Bijli being the man who spearheaded India into this format of theatres.

PVR with its first mover advantage has been able to capture mindshare of the Indian customer with its neat and clean offerings.

Also company has used its first mover advantage to seal the best locations in most metros and its brand is being voted as one of the Top consumer brands in the country consistently.

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Key Investment Highlights

Tremendous Opportunity for Growth – India as a country has the biggest market of moviegoers in the world, the largest pipeline of content, or movies; and most importantly, the lowest penetration of multi-screen exhibition complexes, or multiplexes, in the world. The Indian middle class consumption story has just started to play out in the multiplex arena and we expect significant opportunities arising which will obviously benefit the incumbent leader, PVR Cinemas.

Efficient and Well-Managed company – PVR Cinemas has been an efficient and well managed company which can be seen from the outperformance in Industry parameters like Occupancy levels, Average Ticket price, Higher Margins, Healthy ROCE etc. Moreover, PVR unlike other peers never went for mindless expansion and has always been very conscious of the quality of its offering.

Strong Management – PVR's biggest asset has been its entrepreneurial management led by the Bijli brothers (Ajay & Sanjeev Bijli). Both of them are hands-on in their business approach and bring a tremendous Industry knowledge and experience to the table. From selection of locations to tying up alliances, they have shown great acumen which has helped this company to compete against giants like Cinepolis, Reliance etc.

Aggressive Future Plans – PVR has very aggressive plans to scale up its exhibition business by reaching 500 Screen target by 2015 from the existing count of around 170 screens. Also it has plans to scale up its Retail Entertainment business – PVR BluO by launching new projects across the country. Company has already started working on these aggressive plans by tying up with Mall developers, strengthening its team etc.

Attractive Valuations – PVR is currently quoting at attractive valuations and market is not discounting the growth of the business going forward. Also we feel, PVR deserves a better valuation considering the improvement in its financials which is mainly due to better focus on its core business. The stock is quoting at about 1.1X P/B and around 8X its projected EPS which is pretty attractive considering the quality of the business and the growth in the next few years.

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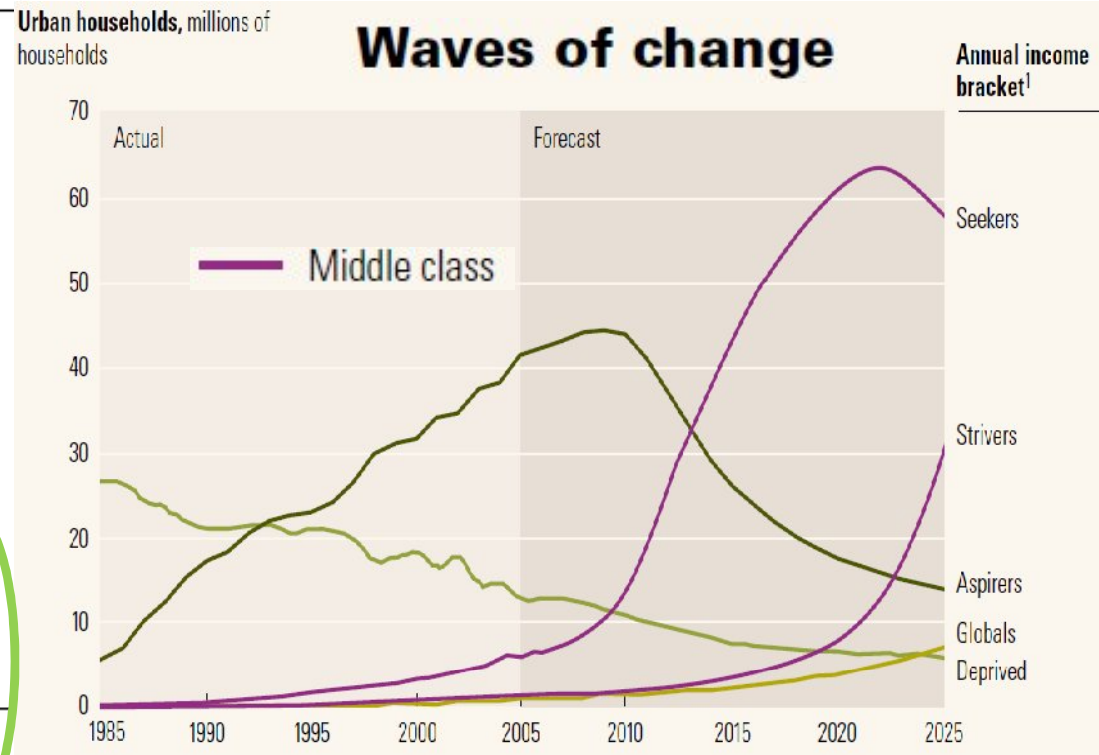
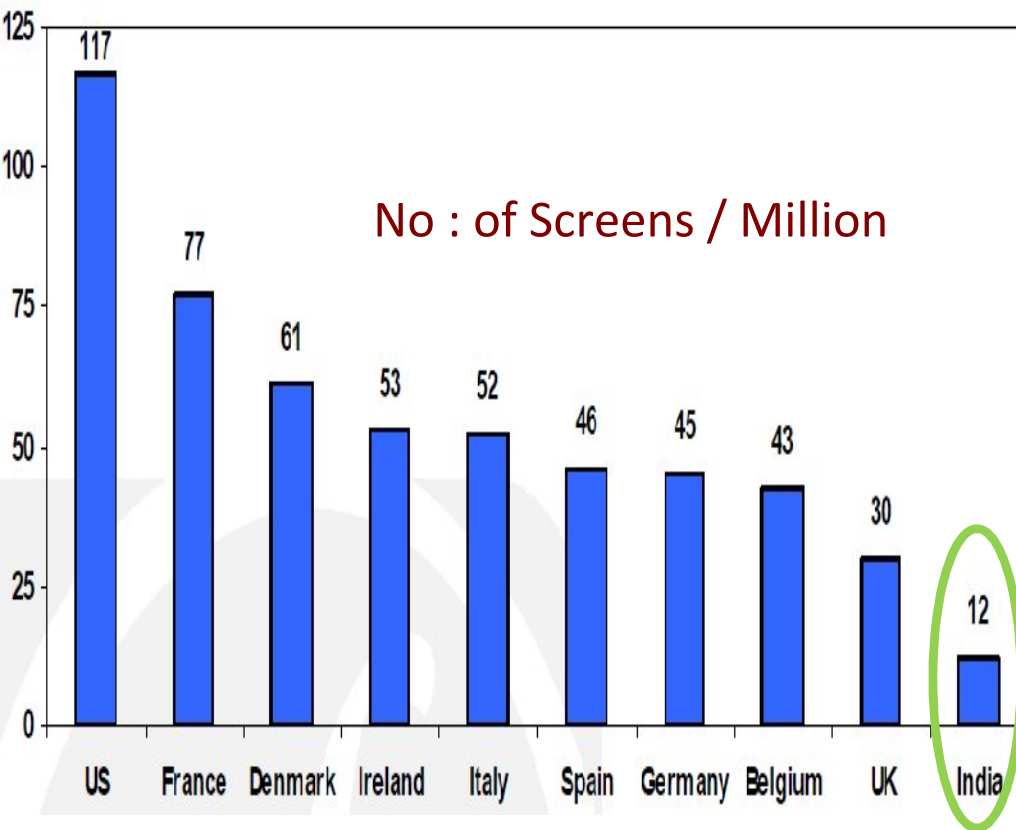
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Industry Opportunity & Potential - An Overview

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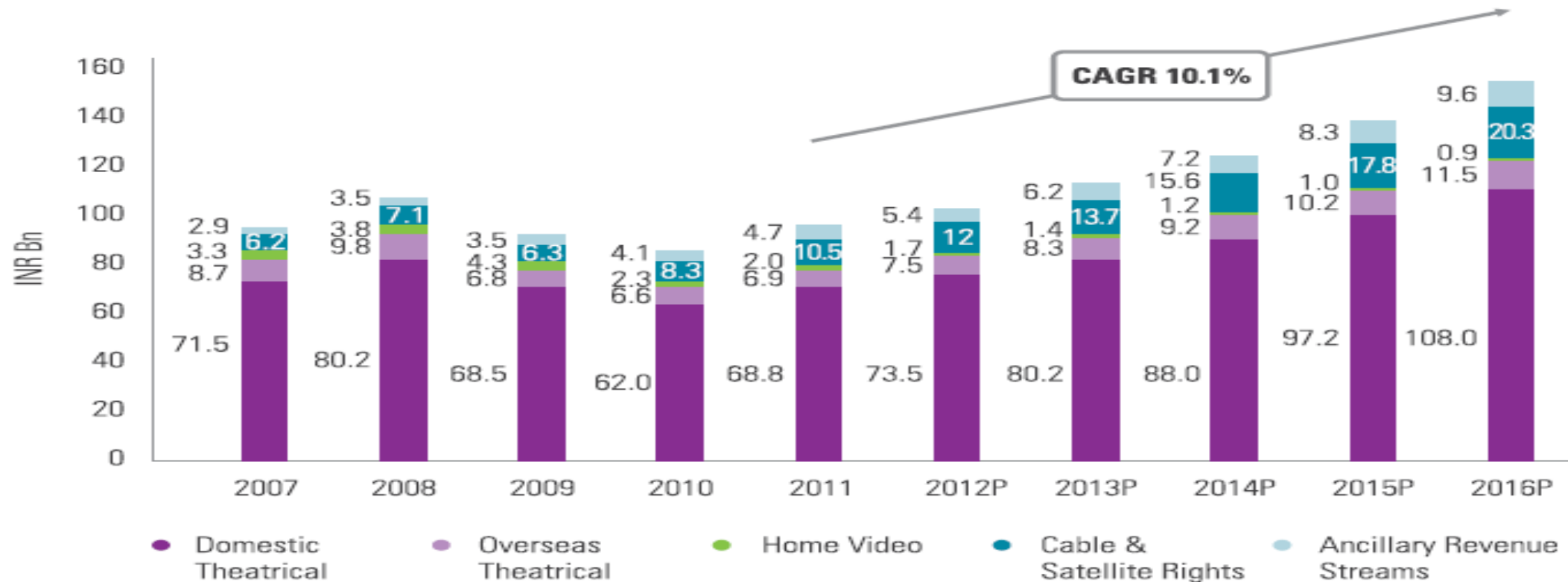
Indian Growth Story



- India is still at the nascent stage of Exhibition business and despite being a **movie crazy country**, India has the lowest number of screens and hence there is tremendous scope for improvement.
- With an expected **Middle-Class of over 30 Cr people**, India is expected to become one of the strongest consumer led economies in the world. The growth which is similar to the “**American baby boom generation**”, will lead to huge opportunities for the Indian consumer focused companies.
- India has a very young population and discretionary spending on Movies is now more **socially acceptable** and with the consumer, moving up the spending chain – we expect an exponential growth in Entertainment.

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Evolution of Exhibition Industry



- With number of movies getting released increasing every year, exhibition industry is expected to get an **improved content flow** which will drive people into theatres and hence a 10% CAGR is expected.
- Even though Single screens have more than **10X** capacity when compared with Multiplexes, they contribute only **35%** to distributor's revenue as compared to over **60%** from Multiplexes and hence the entire movie eco-system requires a **Healthy Multiplex industry** for growth.
- With **Domestic Theatrical revenues** expected to dominate even in the next 5 years, we don't see any visible threat from other platforms which might overtake Movie Exhibition business and moreover we are not seeing these things happening globally as well.

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Multiplex Phenomenon

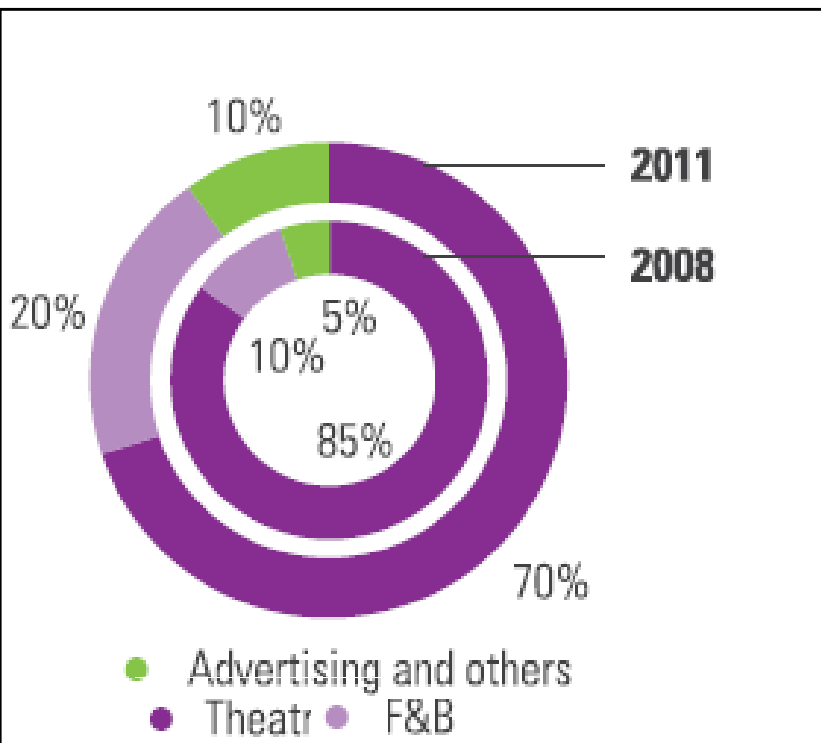


- Indian market has just started to accept the invasion of multiplexes. Even now Single Theatres constitute around **13000 Screens** compared with just under **1000** Multiplex screens. Moreover, Single screens are reducing due to business shut downs on account of low returns.
- India in general has several **structural advantages** in favor of Multiplexes. Main reason being, release of several **regional language** films which helps in better content and higher occupancies across small screens.
- Multiplexes being integrated with **Malls** also provides a healthy relationship as they supplement each other to garner higher footfalls. Also most of the youth like to **hang out** in the malls and hence Multiplexes have become their natural Movie watching location.
- The entire growth in the exhibition industry is driven by emergence of Multiplexes. There is virtually **no Single screens** coming up and a few of them who have access to capital have been **renovating** the old theatre into a small multiplex. But this will not do any good to the **massive investments** needed for new screens in accordance with increased demands for Movies.

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Multiplex Operators Vs Single Theatre owners

Structural Advantages of Multiplex Operators :



1.) Multiplex operators have diversified sources of earnings and **less dependence** on Ticket sales, compared to single theatre owners whose diversification is much lower.

2.) Youth have really taken it to multiplexes and their location advantage with small screens which run **more than 10 films**, helps the user in choosing better. This leads to higher occupancies across good multiplexes.

3.) Being an organized sector, Multiplex operators are also able to **invest capital regularly** to get new technology like digitization, 3D screens etc which the single theatre owners are not able to.

4.) Multiplex owing to their scale of operations, are able to **negotiate better costs** with distributors and are also flexible to host other events in their theatres during the lean periods.

5.) Multiplex operators have been able to actually expand the Movie going pie and this is benefiting everyone in the industry. Customers are having a **good viewing experience** and a hassle free experience in booking tickets.

6.) Digital Screens are enabling Multiplex operators to **penetrate Tier-2 towns** and release movies at par with Metros due to reduced cost.

7.) Organized Multiplex players with **good footfalls** in their big complexes are able to charge higher **advertising revenues** and create a virtuous effect on higher occupancy by lowering the ticket prices substantially.

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PVR Ltd– Business Overview

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Key Highlights

Strong Balance Sheet

PVR has a strong balance sheet which will help it to fund its expansion plans without any aggressive equity dilution.

PVR has one of the best balance sheets in the Industry with Debt: Equity ratio of less than 0.6

Trusted Brand

PVR with its quality cinema viewing experience has been able to establish its brand firmly in the minds of Young Indians. It has been voted as the “Most Trusted Indian Entertainment Brand” by TRA.

Clear Business Focus

PVR has cut-off its loss making production unit and also sold its Mumbai property (>100 Cr) which will help it to focus more on scaling up the Movie Exhibition business which has tremendous potential.



PVR

Healthy Return Ratios

Return on Capital Employed of its Exhibition business is at a healthy 24% before corporate overheads which is very attractive.

Even in its BluO business, company has a ROCE of 28% and pay back of around just 2.5 years.

Business Growth

PVR plans to ramp up its presence across both its business and maintain its leadership position in the market.

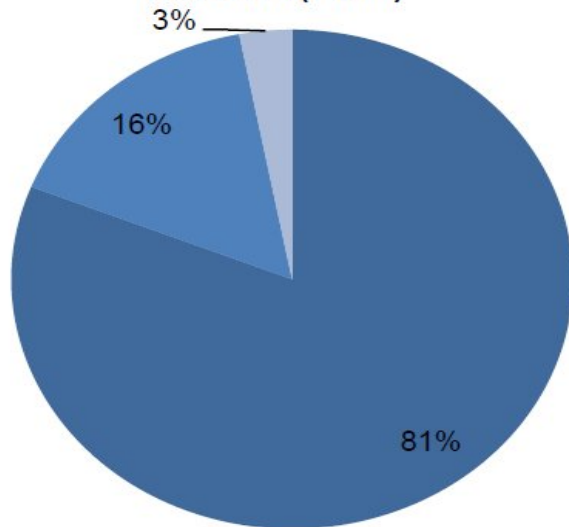
With the revenues and Profitability expected to increase multi-fold, we feel the market is not discounting these into its price.

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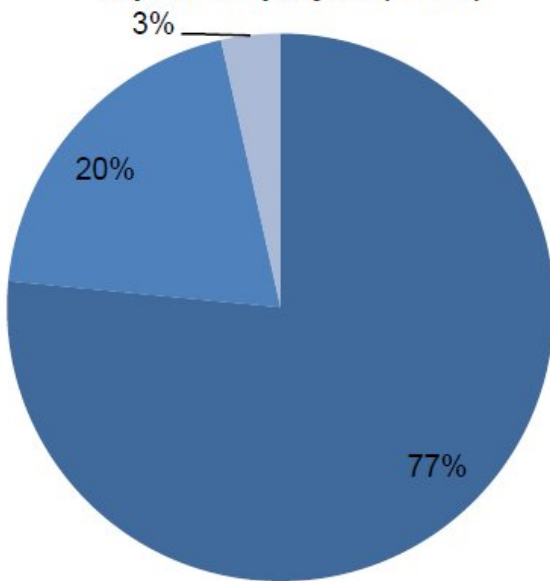
Business Divisions

Revenue (FY11)



■ Exhibition ■ Production & Distribution ■ Bowling Alleys

Capital employed (FY11)



■ Exhibition ■ Production & Distribution ■ Bowling Alleys

Exhibition Business :-

PVR's core business continues to be its exhibition business where it operates under various formats like PVR- Gold Class, Cinema Europa, Director's cut and PVR-Talkies which allows it to straddle across various price points and provide a good cinema experience to the audience. PVR is one of the largest player in this business with over 170 Screens across 20 cities which can house around 35,000 people.

PVR- BluO :-

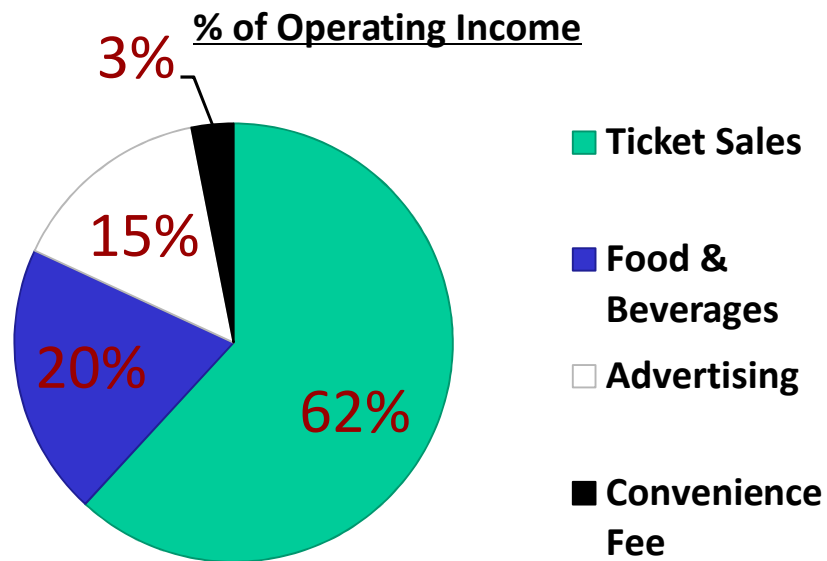
PVR BluO is a relatively new business which is 51:49 JV between PVR and Thailand's Major Cineplex which has tremendous experience in Retail entertainment. They intend to develop properties based on globally successful Holistic Retail entertainment models encompassing Bowling alleys, Skating and Karoke. PVR currently runs this in Delhi where the demand is very strong leading to long queue on holidays.

Production & Distribution :-

PVR tried to integrate vertically by moving to this field and also achieved initial success in Production like "Taare Zameen Par", The business inherently is risky and is a huge lag on the overall finances of the company and hence the management is scaling down.

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Scalable Business Model



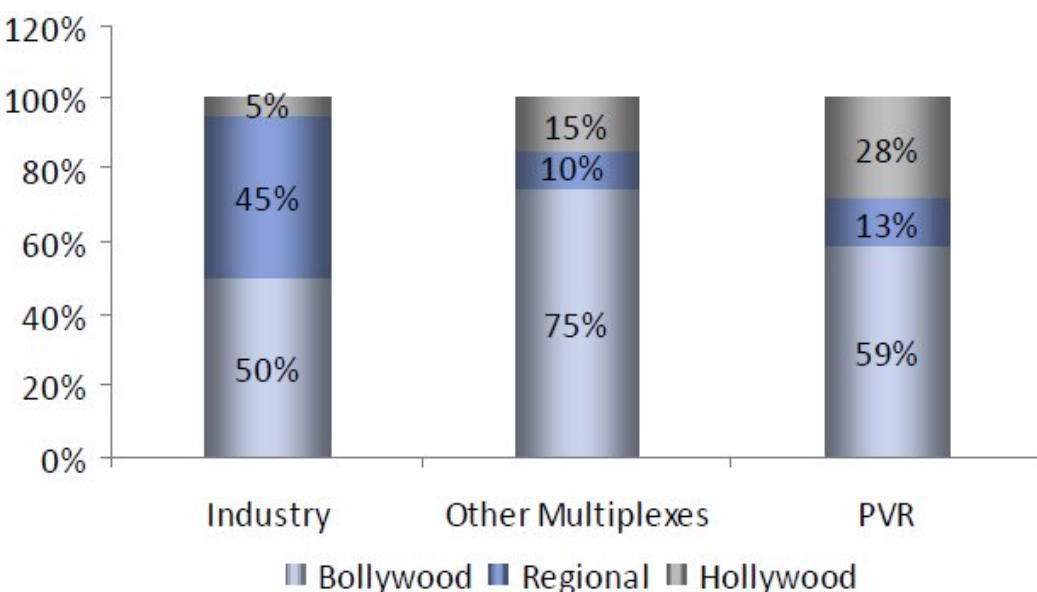
Financial Structure of Exhibition Business	% of Operating Income
Film Distributor's Share	28.17%
Employee Cost	10.8%
Rent	12.8%
Repair & Maintenance	8%
Electricity & Water	5.5%
Other Expenditure	9.6%

- PVR is trying to create **large entertainment centers** in Malls with a combination of Bowling alleys, Karaoke, Ice-Skiing, Movie exhibition and Food court. Considering the success in Delhi, we expect the company to **scale this model** aggressively which will give good returns to shareholders.
- PVR has a strong revenue mix which indicates that the company **milks its customers** much better than other Multiplex operators and with integrated development including BluO, this is only expected to increase.
- PVR runs a very **asset light model** and hence the CAPEX costs are low. Per screen addition costs around **2 Cr Rs** and Per Lane addition costs around **50 Lakh Rs**. With its present cost structure, it makes EBIDTA margins of around 20% which is very healthy.
- Having fine-tuned its operations part, PVR is ready to scale up its business aggressively under both its fronts which will enable it to **maintain its leadership position** in the domestic market.

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Well Managed Business Operations

Particulars	9 Months, FY 12		9 Months, FY 11		Growth (YoY)	
	Comparable Properties	New/ Non Comparable Properties	Comparable Properties	New/ Non Comparable Properties	Comparable Properties	Total Growth
Footfalls (Million)	17.6	0.8	15.4	-	14%	20%
Average Ticket Price (ATP in Rs)	157	139	161	-	-2%	-3%
Food & Beverage Realizations (in Rs)	42.9	36	40.4	-	6%	6%
Advertising Income in (Lakh Rs)	4803	39	3743	-	28%	29%



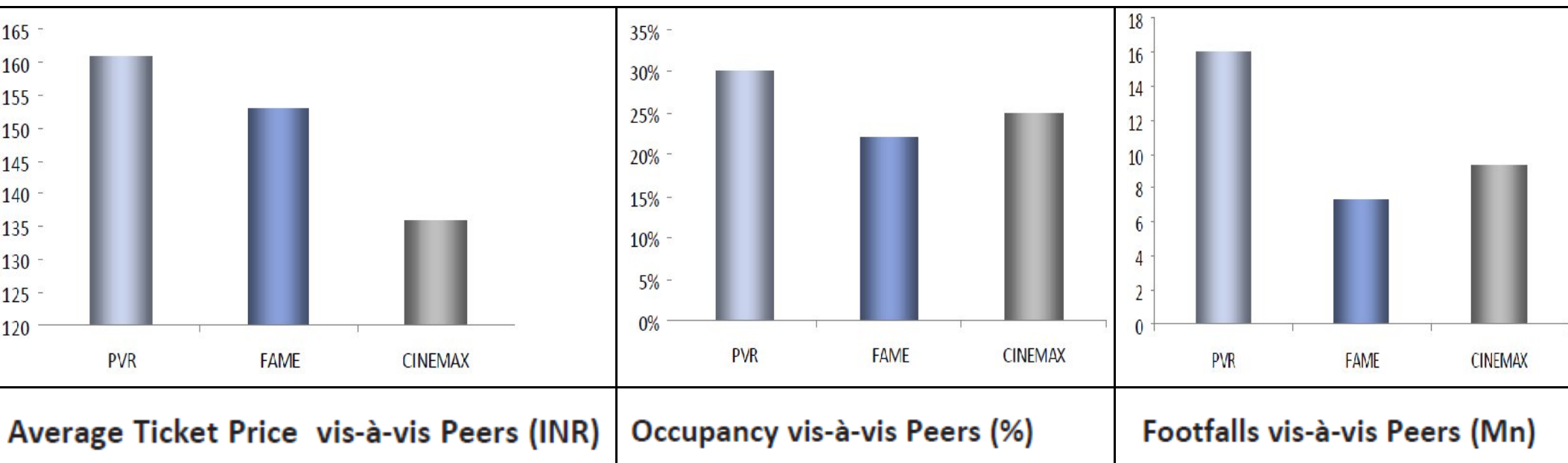
- Company has in the last few quarters tweaked its business model to **increase the number of shows** and hence get more footfalls.

- PVR's **diversified earnings profile** helps it in monetizing its customers better and there has been a healthy growth in this regard.

- PVR being a premium player has a higher **Hollywood mix** in its content mix which are usually more rewarding.

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Important Parameters



PVR has better Industry parameters than all its peers which reiterates our confidence in the quality of the company's operations. Better parameters are the reason why PVR gets a **valuation premium** compared to other listed players and its completely deserved.

- 1.) Company is able to charge more than **10Rs** higher than its near competitors due to its premium positioning. Its Gold Class, Cinema Europa and Director's cut brand commands price of around **250-1000Rs/** Ticket which is like 5-star Cinema Experience.
- 2.) Being present in good locations makes sure than they are the **least hit** in case of a falling demand environment. Hence the occupancy levels are higher and company has a **slight hedge** to content risks.
- 3.) PVR has better occupancy levels and this in turn allows it to charge higher advertizing income and better sales from F&B. Thus it **sweats its assets** much better than peers leading to higher ROIC's.

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Investment Rationale

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Healthy and Fit

Exhibition Business

Particulars (Rs. Lacs)	Capital Employed	Property Level		After Allocation of Corporate Overheads	
		EBIT	ROCE	EBIT	ROCE
Sites operational > 12 months	26,067	6,232	24%	5,233	20%

BluO Business

Similar analysis for BluO business shows, **ROCE > 28%** and a pay back time of less than **3 Years**.

Total Capital Employed in Distribution & Production Business :- > 108 Cr Rs

- PVR's management has taken a wonderful decision to **decrease focus in its Production business** which is risky and focus more on its core exhibition business where it is finding bright prospects. The major mistake which most people make while analyzing PVR is to look at its **consolidated accounts** and vouch that the business has low returns.
- But we tried to break the business and looked at the verticals separately. We find that the core business is very attractive which can be seen from the **ROCE of >24%** in sites which are operational over 12 months. Very few businesses can deliver such returns and more importantly we are not factoring any increase to this number because of efficiency improvements. This in itself will lead to **ROE's between 15-20%**.
- The BluO business is much more attractive with **ROCE of 28%**, but there is chance that it would reduce while scaling up as the demand moves into lower end places. Pay back time of both their business comes around **3 years** which is encouraging for investors and debt holders of PVR.
- The main reason for the bad consolidated numbers is the **huge capital employed in Distribution and Production** and with the management scaling this down – Consolidated numbers will naturally improve a lot. The production pipeline is empty after one Production venture “**Shanghai**” which is releasing next quarter.

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Invisible Moats in the Business

PVR has one of the highest margins in the Industry and has healthy return ratios. One of the main reasons for this better performance has been the management's focus to expand into geographies only where they are able to secure high quality Location space. Management is very particular about it and in fact they approach the business as a Retail company with a clear focus on consumer positioning and satisfying his demands. PVR has been able to outperform Industry with certain competitive advantages which can be found with a little more analysis,

1.) **PVR has the best Mall spaces across the country**, main reasons being

- Good Network of Ajay Bijli. **PVR has tie-ups with high-end mall developers** like Atul Ruia of Phoenix mills, Vikas Oberoi of Oberoi realty and Irfan Razack of Prestige constructions.
- Mall developers are able to **charge 20% extra rent** on other stores just because, there is a presence of PVR Cinemas in the mall which ensures regular footfall in the mall. Hence, PVR and the Good Mall owners are able to create a Win-Win partnership.
- PVR along with its BluO brand and Food courts promoted by Burmans are taking **key anchor tenant position** in most malls which is helping them get a discount and also provide holistic entertainment.
- Mr.Ajay Bijli as an entrepreneur with tremendous experience in multiplexes is able to take the right decisions on location scouting and strictly enters a mall only where the **developer has a long term vision**.

2.) **First Mover advantage** is important and more so in Tier-2 towns, where the first player monopolizes the market. A Good location & First Mover advantage with a credible brand is a killer combination.

3.) **Largest Multiplex player + Up-Market positioning** is also leading to better cost structure and this will improve further going forward leading to better ROE's and generate better cash flows.

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Aggressive Growth Strategy

PVR Cinemas: New screen additions

Location	Screens	Expected opening schedule
Empress Mall, Nagpur	5	Q4, FY11-12
MBD, Jalandhar	4	Q4, FY11-12
Avani Mall, Kolkata	4	Q4, FY11-12
Market City, Pune	9	Q1, FY12-13
Treasure Bazaar Mall, Nanded	4	Q1, FY12-13
Silver Arch, Ludhiana	6	Q1, FY12-13
Orion Mall, Bangalore	11	Q1, FY12-13
Ripples Mall, Vijaywada	4	Q2, FY12-13
Garuda Mall, Mysore	4	Q2, FY12-13
Plaza Center, Pune	7	Q2, FY12-13
Treasure Mall, Ujjain	3	Q2, FY12-13
Market City - Kurla, Mumbai	8	Q3, FY12-13
Diamond Mall, Kolkata	5	Q3, FY12-13
Market City , Bangalore	9	Q3, FY12-13
Total	70	

PVR BluO

Location	Lanes	Expected opening schedule
Orion Mall, Bangalore	28	Q1, FY12-13
Market City, Pune	16	Q1, FY12-13
Plaza Center, Pune	20	Q2, FY12-13
Market City, Bangalore	16	Q3, FY12-13
Total	80	

•PVR has embarked on a very aggressive screen addition which will enable it to reach **500 Screens in 3 years** when compared to the current 170 Screens.

•PVR is venturing into new untapped markets through its “**PVR Talkies**” brand which is positioned as value for money in these price conscious **Tier-2 & 3 towns**.

•PVR has made a significant headway in entering these towns through a lot of tie-ups, being **nimble** and getting ahead of competition.

•On its BluO business, PVR after looking at the success of the first project is now proposing to aggressive scale up with over **80 lanes** of addition before FY-13.

• All these aggressive scale up will be funded through **internal accruals** and debt financing and no equity dilution. This CAPEX will help the company to scale up its revenues tremendously.

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Comparison with Peers

Market players	Screen count (until April'12)	Revenue (9-month ending Dec 2011)	Profit before tax	Pipeline adding screens	Operating profit margin (%)
PVR	170	363 crore	56 crore	Over 350 by 2015	18.60
Cinepolis	34	To reach Rs100 crore in FY12	undisclosed	Over 400 by 2016	Undisclosed
Big Cinemas	Over 250	442 crore	(114) crore	No major expansion plan	Losses
INOX (excluding Fame India)	155	331 crore	27.3 crore	50 in 2012	8.20

- PVR with the best managed operations and significant competitive advantages is able to generate around 20% on its capital. Hence, we don't expect **other players to scale as fast as PVR** because of its relatively easier financing position from its higher Return ratios and Healthy balance sheet.
- The real competition for PVR is expected to come from **Cinepolis** which is a well respected Global brand and operates in the same high-end market as PVR. We expect the competition to be really hot in new Tier-2 markets where both players are new but we believe still the edge is with **Mr. Ajay Bijli**.
- Big Cinemas and INOX are not in the best of health and hence not witnessing any major screen addition as the returns are not lucrative enough to continue raising equity unlike PVR. On the Market-Cap basis we feel that PVR will **widen the valuation differential** with Fame India and Inox because of its quality.

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Financials

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Earnings Projection

Income Statement (INR Cr)	FY 10	FY 11	FY 12A	FY 13E
Sales	334	457	500	585
Total Revenue	343	469	514	600
Film Distributor's Expenses	80	100	123	138
Total Expenses	300	372	415	470
EBIDTA	44	96	98	130
Operating Profit	16.6	29.5	56.8	81.8
Interest Paid	15.9	13.8	14.9	17.4
Tax	0.1	(-15.4)	14.6	18
Net Profit	1.4	8.2	40.8	45.1
EPS	0.57	3.02	15.2	17.84
Total Debt	179.9	161.7	145.8	138.7
RONW	0.4%	2.4%	11.05%	11.02%

- PVR's corporate structure is a bit complex and hence there are lot of variables in accounting and hence the numbers may vary, but the **core spirit of investment returns** remains.

- We expect the company to show good improvements on **EBIDTA level which is more predictable compared** to Net profit. Company Market Cap is currently **<3X its projected EBIDTA** for FY-13.

- With unlocking of over **100 Cr** from the sale of its Mumbai Property, there is enough cash.

- We expect the company to generate significant cash which will help it in not **raising large debts** and also improve its profitability and ROE's.

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Concerns & Reasoning

1.) Capital Intensity for Growth :

Multiplex businesses have little pricing power and hence can't pass on most of its input cost increases. Hence, growth is usually from expansion of new properties which is capital intensive. But we believe looking at PVR's previous track record, Management has been efficient in allocating capital to its exhibition business and is also earning decent returns(>20%) on them.

With improving scale, higher discretionary spending, integrated retail entertainment, Premium products, Better negotiation power with suppliers and lower costs will help in improving its ROCE's even more. We can expect it to improve consistently going forward. We have not taken these positive in our estimates and have left enough margin for error, hence not very concerned about it.

2.) No Solid Differentiating Factor for the Customer :

From the customer point of view, there is very little differentiation between various multiplex operators. People are not very particular to go for a particular brand of multiplex. After a certain level, there is only minute difference between them. But the differentiating factor comes from the management execution, cost structure, location advantage, Promoter connections etc. These in a way provide a good moat for PVR.

Also on the customer side, integrated retail entertainment and better visual experience will make a decent impact on him to choose PVR over other multiplexes, other things being equal. Also, when PVR with so much of advantages is earning ROE's in the range of 15-20% - we don't think the business will be attractive enough for non-serious players. Only when the company starts making big ROE's on this business, will these fringe players be able to raise enough capital to deploy them and only a few will be able to generate sustainable returns from the market.

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Concerns & Reasoning

3.) Increasing Competition Intensity :

The number of players has increased and with the entry of new aggressive players like Cinepolis, the competition is expected to heat up going forward. But we believe, the size of the opportunity is large enough to accommodate new players and as any sun-rise industry will go through interim periods of consolidation. But competition also increases the acceptability of this format to a large number of people and hence expanding the overall pie. PVR being a pioneer will be a beneficiary of this.

One real concern is that the old players or regional players get into this business, who have a lot of sunk cost (Money which already been invested) and also unaccounted black money. Hence the law of un-attractive returns doesn't work with these people which will keep the pricing power of PVR constantly under check due to new supply. We have anyways factored it into our projections.

4.) New Technology Platforms :

Other concerns for people has been the emergence of new platforms like Dish TV with Movies on demand, Internet piracy and mobile platforms which makes the movie viewing easier. But we believe, with still majority of the Producer's revenue coming from theatrical collections – there is no real fear of any technology change as it will affect the creator directly. Even advanced countries like USA and Europe still have a good exhibition business.

We also feel that the Movie going experience is more of an family entertainment rather than to just watch the content, hence people will continue to go to theatres to enjoy their weekend. Also, multiplexes will adopt to provide better content, 3D films, IPL matches or Industry will get re-rated for shorter Film cycles which will ensure little impact of any technological change.

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Conclusion

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Price Chart



Share Holding %	Mar 2012	Dec 2011	Sep 2011	June 2011
Promoters	44.80	44.80	44.80	42.69
FII	3.98	2.97	2.54	7.17
DII	17.51	17.91	18.09	16.20

- ✓ The Stock has been under **consolidation mode** since last eight months after showing a steep correction.
- ✓ PVR used to quote at very high valuations (>30 P/E) in its hey days and a general slow down combined with production losses has ensured **strong correction** in the stock prices.
- ✓ This has enabled long term investors to buy the stock at **very attractive price** which lowers your risk.

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Conclusion

While everyone on the Street seems to believe in the “Indian Consumption Story”, which we can see from the high valuations such stocks quote, there are a few stocks whose growth is also dependent on the Indian Middle class but are quoting at attractive valuations because of certain valid concerns and a lot of misconceptions. PVR Ltd is one such stock which the market is ignoring in spite of very attractive fundamentals and huge potential for growth.

Most of the Consumption stocks which are quoting at high valuations are companies which require very little capital to grow, have sustainable cash flows, High ROE's and hence deserve rich valuations. Though PVR requires lot of investments to grow its business, we feel that the company is able to generate enough returns (ROCE > 20%) and hence deserves better valuations. This is a business where ROE's and Cash flows will improve with every year, as the assets mature and scale of operations increase.

Also the scope of the opportunity is large enough and any improvement in margins will be an added benefit to shareholders. PVR's current Financials show very low ROE's (<5%) but with the actions taken by the management to rationalize non-core business, we expect the ROE's to inch up to 10% in the near term and over 18% in the medium term. These improvements will get reflected in the stock price sooner or later.

A company which is the leader of a sunrise industry with well managed operations is available at less than 1X its projected Book value and less than 9X its projected revenues. If the business environment improves and company is able to scale its business (which we believe will happen), PVR will be a stock which will be a big multi-bagger. PVR is a stock where there is considerable amount of risk, but the potential returns far outweigh it and hence investors can take an investment bet on it.

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Best Way to generate Alpha for your portfolio

HBJ Market Performer Service is focused on helping Institutional Clients beat market returns by a wide margin without taking large risks through in-depth research and analysis of the stock.

*For more information on **Sanghvi Movers** and the opportunity in it, feel free to discuss with **Gokul Raj. P***

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Index Trading*

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PROVIDE OUR CUSTOMERS WITH VALUE.

EXCELLENCE: TO OUTPERFORM & BE MARKET
PIONEERS WITH THE QUALITY OF OUR
PRODUCTS & SERVICES.

ETHICS: WE ENSURE THAT ALL OUR
RELATIONSHIPS ARE DEALT WITH
TRANSPARENTLY AND IN FAIRNESS.

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