Sharekhan
by BNP PARIBAS

Media & Entertainment

The show just got bigger

Sector: Consumer Discretionary

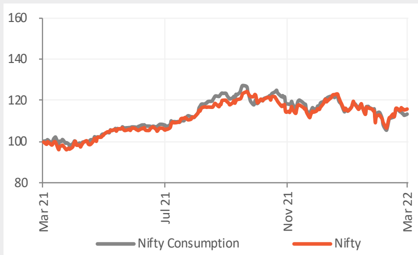
View: Positive

Coverage universe

Companies	CMP (Rs)	Reco.	PT (Rs)
PVR Limited	1,884	Buy	2,250
Inox Leisure	523	Buy	675

Source: Company data, Sharekhan estimates

Price chart



Source: Sharekhan Research

Summary

- The merger of PVR and INOX Leisure would create India's largest film exhibition company with 1,546 operating screens across 341 properties and 109 cities.
- As per the deal, Inox Leisure's shareholders will receive three shares of PVR for every 10 shares of Inox Leisure. Based on the swap ratio, Inox Leisure is valued at Rs. 548 per share, which is favourable for its shareholders.
- The strategic rationale behind the merger are – (1) Significant revenue and cost synergies, (2) Healthy balance sheet to drive screen additions, (3) Strong bargaining power across value chain, (4) Foray into tier-II and tier-III towns and (5) scale to counter the threat from the OTT platforms.
- We maintain a Buy on both PVR and Inox Leisure with revised price targets of Rs. 2,250 and Rs. 675, respectively. The combined entity could command a premium valuation considering the possibilities of significant revenue and cost synergies.

PVR Limited (PVR) and Inox Leisure, the two largest players in Indian multiplex industry, approved an all-stock amalgamation of both the entities on March 27, 2022. The combined entity will become the largest multiplex company in India with 1,546 operating screens across 341 properties and 109 cities. We believe that this transaction does not require for CCI approval for this merger as FY2021 revenues were below Rs. 1,000 crore for both entities. Though multiplexes account for 33% of total screens in India, revenue of Indian multiplex industry is around 55% of total box office collections. As the combined entity will have around 50% market share in terms of screens in multiplex space, we believe it will be well-placed to drive its growth going ahead given rising youth population, permanent closure of single screens, healthy box office collection, under-penetration of screens in India and enhanced facilities in the cinemas across the country. Both PVR and Inox Leisure have more than 1,000 screens each on their pipeline to open over next 5-10 years, which would provide the combined entity a strong competitive advantage. With significant synergies on both revenue and cost fronts, we believe the combined entity will benefit from economies of scale and could command a premium valuation considering strong earnings growth potential post-merger.

- **Event: A mega merger:** PVR and INOX Leisure announced merger on March 27, 2022. As per deal, the swap ratio remains at three shares of PVR for every 10 shares of Inox Leisure. Upon completion of merger, the Board of Directors of the merged company would be re-constituted with total board strength of 10 members and both the promoter families having equal representation on the Board with two board seats each. Post the merger, Inox leisure's promoters will have a 16.66% stake while PVR promoters will have 10.62% stake in the combined entity. New cinemas opened post the merger will be branded as PVR-Inox. The merger is subject to approval of the shareholders of both the entities, stock exchanges, SEBI and other regulatory approvals. However, we believe that this transaction does not require for CCI approval for this merger as FY2021 revenues were below Rs. 1,000 crore for both entities. The management expects the transaction is likely to close in the next 6-9 months.
- **Merger ratio appears slightly favourable to Inox Leisure:** As per deal, Inox Leisure's shareholders will receive three shares of PVR for every 10 shares of Inox Leisure. Based on the swap ratio, Inox Leisure is valued at Rs. 548 per share. At Rs. 548, the deal values Inox Leisure at 14x EV/EBITDA (as per Ind-AS) on a FY2020 basis and EV/screen of Rs. 9.2 crore. Hence, we believe that the swap ratio is favourable to Inox Leisure's shareholders. The merger is expected to bring in enhanced productivity, deeper reach in newer markets and cost optimisation opportunities. With significant synergies, the combined entity would command a premium valuation, which in turn would translate to a higher upside potential for Inox Leisure.
- **Overall, a win-win for all; we expect significant synergies:** The strategic rationale for this merger are – (1) significant revenue synergies – scope for Inox-Leisure to move towards premiumisation in its average ticket price (ATP) and spend per head (SPH). Further, there will immediate benefit in terms of ad revenue post-merger as Inox Leisure's advertising revenue per screen remains around 35% discount to PVR. We believe the combined entity will get better yields on advertising given the screen network. (2) higher cost efficiencies – This transaction will create a favourable environment for the combined entity given limited competition post the merger. The company may derive benefits on other costs such as rentals, content cost, marketing spends and F&B sourcing. There will be savings in operating cost at corporate level, (3) Healthy balance sheet to drive screen additions – the merged entity will target adding around 200 screens every year, (4) Strong bargaining power across value chain - increased bargaining power with producer-distributor entities and online ticket platforms, (5) increasing penetration into smaller towns and/or international markets – the combined entity will enter into tier-II and tier-II cities to gain market share from smaller chains and single screens, (6) scale to counter the threat from the OTT platforms. Both PVR and Inox Leisure have more than 1000 screens each on their pipeline to open over next 5-10 years, which will provide the biggest competitive advantage.

Valuation: A firm handshake: Based on our estimates (excluding synergies), the combined entity will generate revenue of Rs. 7,078 crore and an EBITDA of Rs. 2,374 crore (as per Ind-AS). As the combined entity would contribute around 50% of total number of screens in Indian multiplex, it would have significant bargaining power in terms of rentals, content cost, marketing spends, F&B sourcing and revenue sharing with producer-distributor entities. Post the merger, the unit economics of Inox Leisure would come on par with PVR given economic of scale, potential geographical diversification and implementing the best practices of PVR. At 12x target multiple on the combined EBITDA of FY2024E, we arrive the target price of Rs. 2,250 for PVR and Rs. 675 for Inox Leisure. We maintain Buy rating on both PVR and Inox Leisure.

Key risks

(1) Deterioration of content quality might affect footfalls and advertisement revenue growth, (2) inability to take adequate price hikes at the right time might affect earnings given rising input costs and (3) a delay in return to normalcy.

PVR Limited - Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	280.0	1,368.4	3,971.8	4,470.7
OPM (%)	NM	-1.7	33.4	34.1
Adjusted PAT	-747.8	-431.1	261.9	330.4
% y-o-y growth	*NM*	*NM*	*NM*	*26.1*
Adjusted EPS (Rs.)	-135.6	-71.0	43.1	54.4
P/E (x)	NM	NM	43.7	34.6
P/B (x)	6.2	8.2	6.9	5.8
EV/EBITDA (x)	NM	NM	11.8	10.3
RoNW (%)	NM	NM	17.1	18.2
RoCE (%)	NM	NM	10.4	11.4

*Source: Company; Sharekhan estimates; * numbers are based on Ind AS 116.*

Inox Leisure - Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	105.9	842.0	2,190.4	2,607.4
OPM (%)	47.0	30.6	32.2	32.6
Adjusted PAT	-337.7	-200.9	146.1	222.9
% y-o-y growth	*n.m.*	*n.m.*	*n.m.*	*52.6*
Adjusted EPS (Rs.)	-32.2	-16.4	12.0	18.2
P/E (x)	n.m.	n.m.	43.7	28.7
P/B (x)	7.6	11.1	8.3	6.0
EV/EBITDA (x)	173.0	33.1	12.0	9.8
RoNW (%)	n.m.	n.m.	28.9	32.3
RoCE (%)	n.m.	n.m.	20.6	23.8

*Source: Company; Sharekhan estimates; * numbers are based on Ind AS 116.*

Event: PVR and Inox Leisure announce a mega merger

The Board of Directors of PVR and INOX Leisure in their respective meetings held on March 27, 2022, approved an all stock amalgamation of Inox Leisure with PVR. This merger will bring together two of India's largest film exhibition companies and the combined entity will become the largest multiplex company in India with 1,546 operating screens across 341 properties and 109 cities. As per the deal, the swap ratio remains at three shares of PVR for every 10 shares of Inox Leisure. Post the merger, the promoters of Inox Leisure will become co-promoters in the merged entity along with the existing promoters of PVR. Upon completion of merger, the Board of Directors of the merged company would be re-constituted with total board strength of 10 members and both the promoter families having equal representation on the Board with two board seats each. Mr. Ajay Bijli and Mr. Sanjeev Kumar will be appointed as managing director (MD) and executive director (ED) respectively, while Mr. Pavan Kumar Jain and Mr. Siddharth Jain will be appointed as the non-executive chairman and non-executive director, respectively. Post the merger, Inox leisure's promoters will have 16.66% stake while PVR promoters will have 10.62% stake in the combined entity. The combined entity will be named as PVR-INOX Limited with branding of existing screens to continue as Inox and PVR respectively. New cinemas opened post the merger will be branded as PVR Inox. The merger is subject to approval of the shareholders of both the entities, stock exchanges, SEBI and other regulatory approvals. However, we believe that this transaction does not require for CCI approval for this merger as FY2021 revenues were below Rs. 1,000 crore for both entities. The management expects the transaction is likely to close within the next 6-9 months.

Consolidation in multiplex industry: A blockbuster deal

The largest Indian film exhibition player (by number of screens), PVR and the second largest, Inox Leisure announced a merger of both the entities. The Indian multiplex industry had four major multiplex operators during pre-pandemic (together at ~63% of total multiplex screens) with PVR, Inox Leisure, Carnival and Cinepolis. Post the deal, the combined entity will have around 50% market share in terms of screens in multiplex space and around 15% market share of total screens (including single screens) in India. Though multiplexes account for 33% of total screen counts in India, revenue of Indian multiplex industry is around 55% of total box office collections. Hence, we believe India multiplex market will continue to grow going ahead on the back of a rising youth population, growing urbanisation and hence, rising demand for better infrastructure, permanent closure of single screens (because of shut down of cinemas owing to lockdowns and restrictions), healthy box office collection, under-penetration of screens in India and enhanced facilities in the cinemas across the country. The managements of both the entities have indicated that they will continue to expand by adding screens in tier-II and tier-III cities in India.

Merger appears slightly favourable to Inox Leisure

As per deal, Inox Leisure's shareholders will receive three shares of PVR for every 10 shares of Inox Leisure. Based on the swap ratio, Inox Leisure is valued at Rs. 548 per share. At Rs. 548, the deal values Inox Leisure at 14x EV/EBITDA (as per Ind-AS) and EV/screen of Rs. 9.2 crore on a FY2020 basis. Hence, we believe that the swap ratio is a tad favourable to Inox Leisure's shareholders. Based on our estimates (excluding synergies), the combined entity will generate revenue of Rs. 7,078 crore and an EBITDA of Rs. 2,374 crore (as per Ind-AS). The net debt of the combined entity is expected to be below Rs. 6,800 crore in FY2024E. The combined entity will have good presence across the country. PVR has strong presence in the North, West, And South whereas Inox Leisure has more screens in the West and East. The merger is expected to bring in enhanced productivity, deeper reach in newer markets and cost optimisation opportunities. Hence, we believe that the merger will benefit both the companies in terms of economics of scale and the combined entity has the potential to trade at higher multiple as compared to PVR's pre-pandemic multiple.

Overall, a win-win for all; we expect significant synergies in both revenue and cost fronts

PVR and Inox Leisure merger will create a mega multiplex operator in the film exhibition industry in India with a 1,545+ screen network (~50% share of the total Indian multiplex screens) across the country. The strategic rationale for this merger are – (1) Significant revenue synergies – scope for Inox Leisure to move towards premiumisation in its average ticket price (ATP) and spend per head (SPH). Inox Leisure's ATP and SPH were 5-20% discount to PVR during the pre-pandemic times. Further, the company will opt new food offerings and best practices of PVR in F&B segment to improve the SPH of Inox leisure. Though we understand the improvement in ATP and SPH will depend on content and location, the combined entity would take measures to bridge the gap in the near-term. Further, there will immediate benefit in terms of ad revenue post\ the merger as Inox Leisure's ad revenue per screen remains around 35% discount to PVR. We believe the combined entity will get better yields on advertising given the size of screen network. Similarly, Inox Leisure also derives a lower convenience fee per screen compared to PVR, which would improve gradually under the combined entity as it depends on locations; (2) Drive cost efficiencies – this transaction will create a favourable environment for the combined entity given limited competition post the merger. The company may derive benefits on other costs such as rentals, content cost, marketing spends and F&B sourcing. There will be savings in operating cost at corporate level, (3) Leverage balance sheet to drive screen additions – the merged entity will target adding around 200 screens every year, (4) Significant bargaining power across value chain - increased bargaining power with producer-distributor entities and online ticket platforms, (5) penetration into smaller towns and/ or international markets – the combined entity will enter into tier-II and tier-II cities to gain market share from smaller chains and single screens, (6) well-placed to counter the threat from the OTT platforms – The merger will provide a strong theatrical platform to deal any threat from OTT players in the near term. We believe the scale of network of the combined entity will become the first preference for the movie producers to release their content. Further, the market share of the combined entity in number of screens will improve going ahead as the merged entity has already signed up agreements with the many real estate developers to open screens once property is ready to use. Both PVR and Inox Leisure have more than 1000 screens each on their pipeline to open over next 5-10 years, which will provide the biggest competitive advantage to the merged entity, as we believe the other small multiplex players don't have balance sheet strength/option (because most developers don't prefer small multiplex operators) to compete with the combined entity.

Inox Leisure is valued at 17% premium

Inox Leisure's share outstanding (no in cr)	12.2
Number of PVR's share to be received	3.7
Share price of PVR (March 25, 2022)	1828
Implied value of Inox Leisure (Rs. crore)	6,708
Net debt (Rs. crore)	-10
Implied market cap of Inox leisure	6,718
Market cap of Inox Leisure at which deal announced	5,746
Premium to market cap	**17%**

Source: Company, Sharekhan Research

Combined entity will have a strong presence across India

Region	PVR	Inox Leisure	Total
South	34%	22%	29%
West	31%	38%	34%
North	30%	25%	28%
East	5%	15%	9%

Source: Company, Sharekhan Research

Unit economics comparison

Unit economics	PVR	Inox Leisure	Differential
Screens	860	667	-22%
Revenue per screen (in cr, FY2020)	4.0	3.0	-25%
EBITDA per screen (in cr, FY2020)	1.3	1.0	-25%
Footfall (in mn, in FY2020)	101.7	66	-35%
ATP (Q3FY22)	239	226	-5%
SPH (Q3FY22)	129	97	-25%
Ad revenue/ screen (FY2020)	0.4	0.3	-35%
Convenience fee/ screen (FY20)	2.0	1.1	-48%

Source: Company, Sharekhan Research

Calculation of target price

Unit economics	PVR	Inox Leisure	PVR + Inox
Revenue (FY2024E)	4,471	2,607	7,078
EBITDA (FY2024E)	1,524	851	2,374
Net debt (incld. Leases, FY2024E)	4,308	2,488	6,795
Target EV/EBITDA (x)			**12**
Implied EV			28,745
Equity value			21,950
Shares Outstanding (cr)			9.8
Target price			**2,250**
For Inox Leisure shareholders			
Implied Inox Leisure TP			**675**
CMP of Inox Leisure share			523
Upside potential (%)			29%
For PVR shareholders			
Implied PVR TP			**2,250**
CMP of PVR shares			1,884
Upside potential (%)			19%

Source: Company, Sharekhan Research

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