March 29, 2022

Mega merger in the making!!!

PVR and Inox have announced a merger with an all stock amalgamation of Inox with PVR. The MergedCo will become the largest film exhibition company in India with 1,546 screens, at ~50% multiplex screen market share and ~42% box office collection market share.

Key highlights of merger

- Shareholders of Inox will receive three shares of PVR in exchange for 10 shares in Inox. We note that that this implies that Inox has been valued at 16% higher than Friday's closing (₹ 469), assuming PVR's share price (₹ 1820) as base in the swap
- Post the merger, PVR promoters will have a 10.62% stake while Inox promoters will have a 16.66% stake in the combined entity
- Both promoters with equal representation in the board with two seats each in 10-member board. PVR promoters Ajay and Sanjeev Bijli would be MD and ED, while Siddharth Jain and Pawan Jain would be Non-Executive Chairman and Director, respectively. New screens would be rolled out under the PVR-Inox brand while old brands of PVR and Inox will remain for existing screens
- As per the companies, their counsel has advised that with target company turnover is less than ₹ 1000 crore, the merger has "*de-minimus exemption* from CCI approval" and needs no CCI filing. However, as per our view, the uncertainty will loom over this reconstitution as CCI can seek various explanations regarding the scheme at any given point of time
- The merger may take six to nine months to get completed

Synergy of scale likely on revenues, costs & growth

We highlight that the management has indicated that they are yet to work on synergy numbers. Key synergy, in our view, will be bargaining power across the value chain given the scale boosting the revenues, costs and expansion pace with bigger balance sheet. On revenues, the low hanging segment would be advertisement [with Inox whose normalised (pre-Covid) ad/screen/annum was at ~₹ 29 lakh vs. ₹ 44 lakh for PVR) ~36% discount] as well as wider F&B offering ramping up SPH for combined entity. Furthermore, they would have higher leverage in convenience fee deals (when it comes for renewal in FY24) and distribution revenues opportunities. Some administrative cost rationalisation on overlaps as well as well as higher F&B margins with scale led single sourcing and wider menu is likely. Cumulatively, we expect Synergy benefits of ~₹ 200 crore on EBITDA levels (ex-Ind AS)- ₹ 100 crore on revenues and ~₹ 100 crore on costs) – please refer page three for synergy maths.

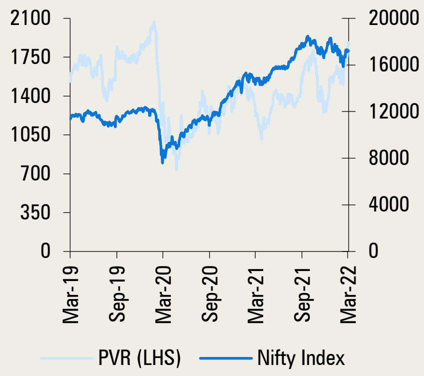
Merged entity reach & synergy to drive rerating in multiples

We note that along with bigger entity with synergy benefits, MergedCo will benefit from faster growth trajectory (the management is looking to add 200+ screens every year and ~2000 screens over the next seven years). In terms of risks, uncertainty on CCI steps ahead will remain. However, consummation of merger will result in entity with higher revenues and margins potential. We **maintain BUY on both PVR and Inox Leisure assigning a EV/EBITDA multiple of 14x on the MergedCo FY24 EBITDA** (vs. 13x for PVR and 11x on Inox, earlier). **We assign a target price of ₹ 2265/share for the MergedCo and PVR.** The subsequent **target price for Inox is ₹ 680/share** as per the swap ratio.

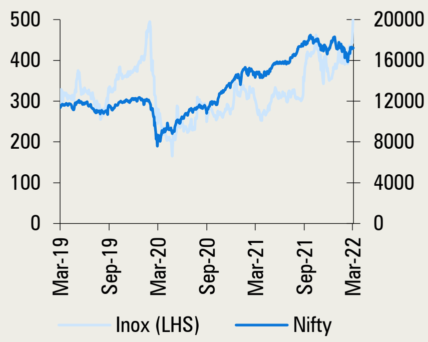
Rating & Target price (₹)

	Rating	CMP	TP	Upside (%)
PVR	Buy	1,883	2,265	20
Inox	Buy	523	680	30

PVR – Share Price



Inox Leisure – Share Price



Key Risks

1.Delay/hindrance in merger due to CCI intervention

2.Any further wave of pandemic impacting performance

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Sector Update

ICICI Securities – Retail Equity Research

Conference Call Highlights

- **OTT and multiplex to coexist** - PVR highlighted that the merger was driven by need to expand at a rapid pace. IT highlighted that while OTT proliferation picked up in the Covid period, recent collections suggests that multiplexes are vital for movie economics. It expects OTT platforms as well as the multiplex formats to co-exist as out of home entertainment options remain limited in India

- **Focus on cost, revenue synergies**: Both managements highlighted that the merged entity would seek to drive economies of scale through though higher revenue streams such as advertisements / food & beverages and cost synergies (capex and other operational costs). The Inox management also highlighted that it would leverage PVR's ancillary businesses (F&B, distribution, etc) and will expand it across its own network. It added that historically, PVR has shown strength across F&B, marketing programmes, overall look and feel of screens and selection of prime property location

- **New screens under 'PVR Inox' Brand; managements aligned**: Post completion of the merger, the PVR management team will control day to day operations and new screens would be rolled out under the PVR-Inox brand while old brands of PVR and Inox will remain for existing screens. The management teams of PVR and Inox remain aligned on the direction of the businesses key focus would be on customer experience and targeting various price points across category. The PVR management would be in charge of day to day operations of the merged entity while Inox promoters will have representation across two board seats (same as PVR promoters) and will remain in an advisory/strategic role

- **Screen addition to ramp up**: The merged entity plans to open 200+ screens annually out of which ~130 are currently undergoing fit-outs. Tier 2 and 3 cities remain one of the key growth drivers for the merged entity given the encouraging initial response and smaller malls are also opening up in these locations

- **No rationalisation in number of screens/employees likely:** The managements indicated that there is unlikely to be any rationalisation in screens as historically PVR and Inox have largely avoided the same catchment area and the merged entity could rather hire employees with sharp growth aspirations

- **No minimum lock in/restriction on stake addition:** The promoters of both PVR and Inox have indicated that they are open to conclude transactions and indicated that there are under no minimum lock-in period or restrictions on stake increase. The Inox management may consider increasing stake in the merged entity as it remains optimistic on the business prospects

Synergy Mathematics

Revenues:

a) **Box office: We do not see any major synergy in the given head** of revenues as it is largely led by location of the screens. As per the management also, like to like average ticket price (ATP) for both PVR and Inox remain similar for similar locations

b) **Food and beverage:** While spends per head currently are clearly different across PVR and Inox due to locations, menu offering etc. We expect PVR menu integration/selling strategy to result in **synergy of ₹ 45 crore in F&B revenues in FY24, assuming ~5% higher spend per head for Inox screens ahead.**

c) **Convenience Fee:** We note that on convenience fee/screen metric, Inox (pre-Covid) was ~45% lower. While, partly it was function of location, PVR's superior monetisation was key factor. **We expect Inox to cover up around half of this disparity as MergedCo, resulting in ~₹ 25 crore synergy in revenues in FY24.**

d) **Advertisement**: The low hanging synergy segment would be advertisement (with Inox whose normalised (pre-Covid) ad/screen/annum was at ~₹ 29 lakh vs. ₹ 44 lakh for PVR) ~36% discount). **MergedCo to get synergy of ₹ 40 crore, as half of the discount is likely to go away with network**, while some discount for Inox screen to remain given location

Costs: We have baked in ₹ 100 crore synergy in costs spread across F& B costs (~2% lower given single sourcing), employee costs (~2% lower for MergedCo given integration) and other costs (~3% lower for MergedCo given the rationalisation/scale benefits in overheads).

Exhibit 1: How Inox PVR stack up in metrics

FY20 metrics (Pre-Covid era) ₹ crore	Inox	PVR
Box office Revenues	1,104.0	1,731.6
F&B	497.0	948.7
Ad	179.0	375.9
Convenience	66.8	171.9
Others	50.6	186.3

KPIs	Inox	PVR
ATP (₹)	199.7	204.4
Footfalls (mn)	66.0	101.7
Screens	626	845
Advertisment/screen (₹lakh)	0.29	0.44
Convenience Fee/screen	0.11	0.20
Spends per head (₹)	79.8	98.3

Source: Company, ICICI Direct Research

Exhibit 2: MergedCo – Operating profits and valuations

	Inox			PVR			Merged Co	Merged Co
(Year-end March)	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY24E (without Synergy	FY24E (with Synergy
Box Office Revenues	*272*	*1,277*	*1,511*	*451*	*1,935*	*2,271*	*3,782*	*3,782*
F&B	*133*	*613*	*728*	*294*	*1,197*	*1,424*	*2,153*	*2,193*
Advertisement	*25*	*140*	*160*	*73*	*360*	*400*	*560*	*600*
Convenience & Others	*29*	*90*	*100*	*85*	*164*	*347*	*447*	*472*
Total operating Income	**458.8**	**2,119.5**	**2,499.2**	**981.9**	**3,839.0**	**4,447.9**	**6947.0**	**7047.3**
Growth (%)	333.1	362.0	17.9	250.7	291.0	15.9	16.6	18.3
Employee Expenses	96.2	140.1	160.9	267.0	389.1	457.2	618.2	605.8
Exhibition Cost	132.5	593.7	702.6	186.2	890.3	1,033.5	1,736.1	1,736.1
Cost of F&B	29.8	165.4	205.3	79.9	335.0	398.9	604.2	592.1
Other Expenses incl. Rent	398.7	826.6	928.3	835.5	1,493.7	1,645.2	2,573.5	2,497.5
Total Operating Expenditure	657.1	1,725.8	1,997.2	1,368.5	3,108.2	3,534.8	5,531.9	5,431.6
EBITDA	**-198.4**	**393.7**	**502.0**	**-386.6**	**730.9**	**913.1**	**1,415.1**	**1,615.7**
Margin (%)	-43.2	18.6	20.1	-39.4	19.0	20.5	20.4	22.9
							Ev at 14x EBITDA	**22,620**
							Less Debt	**500**
							Equity Value	**22,120**
							Per share value	**2,265**
							Inox Per share value	**680**
							(based on swap ratio)	

Source: Cabinet Press Briefing and Release, ICICI Direct Research

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Sell: <-15%

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