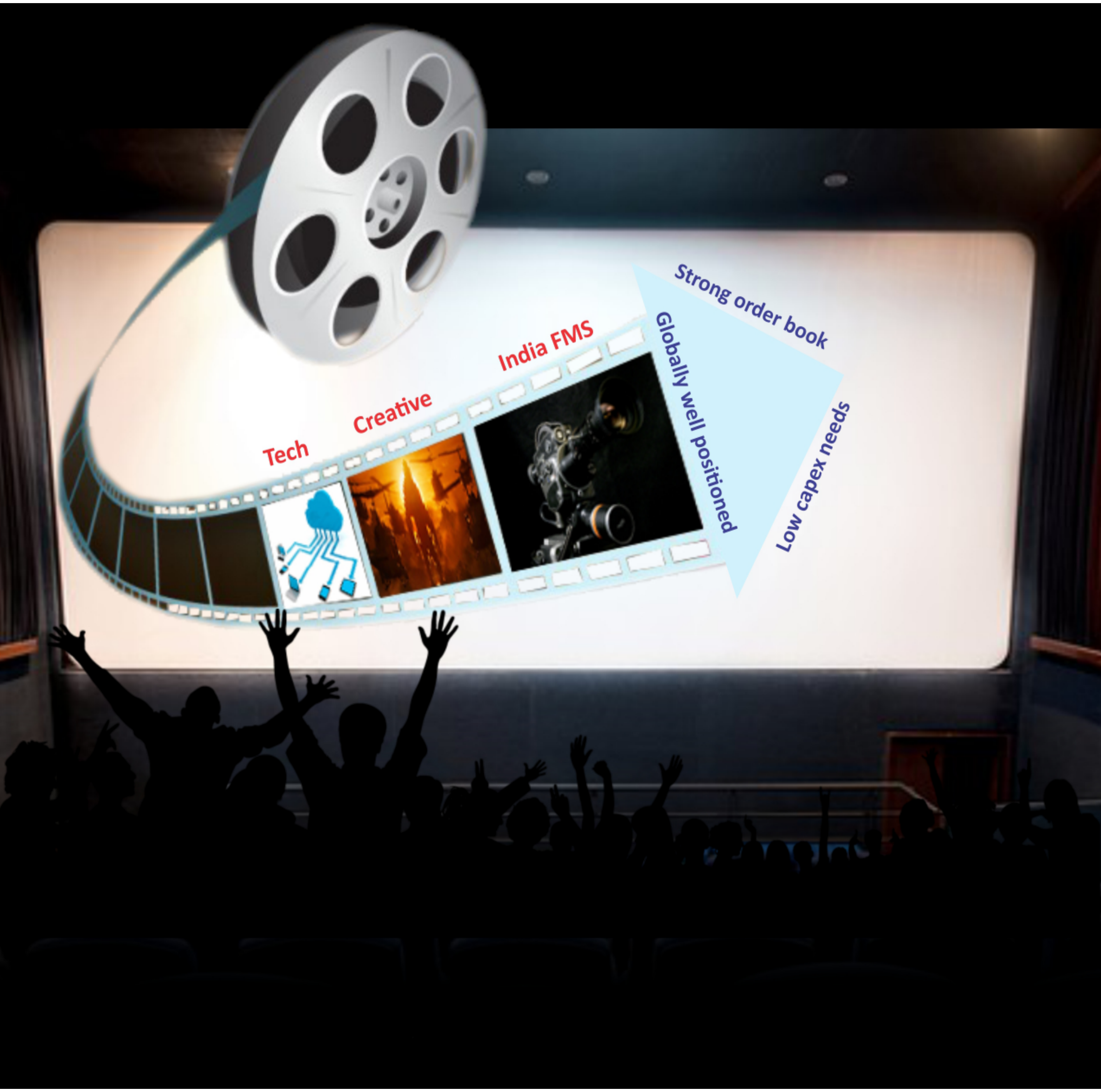
Initiating Coverage | 16 October 2017
Sector: Media

Prime Focus



Set to run the show

Aliasgar Shakir - Research analyst (Aliasgar.Shakir@motilaloswal.com); +91 022 6129 1565
Hafeez Patel - Research analyst (Hafeez.Patel@motilaloswal.com); +91 22 6129 1568

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Prime Focus

BSE Sensex	S&P CNX
32,634	10,231

CMP: INR89 **TP: INR130 (+46%)** **Buy**

PRIME FOCUS LIMITED

Stock Info

Bloomberg	PRIF IN
Equity Shares (m)	298.9
52-Week Range (INR)	124 / 63
1, 6, 12 Rel. Per (%)	-13/-25/5
M.Cap. (INR b)	27.4
M.Cap. (USD b)	0.42
Avg Val, INRm	11
Free float (%)	65.0

Financial Snapshot (INR b)

Y/E MARCH	FY17	FY18E	FY19E
Net Sales	21.5	24.7	28.4
EBITDA	4.8	5.5	6.5
Adj. NP	0.4	0.9	1.8
Adj.EPS (INR)	1.2	3.0	5.9
EPS Gr.%	LP	147.7	94.3
BV/Share	18.6	21.6	27.5
Adj. P/E (x)	73.0	29.5	15.2
P/BV (x)	4.8	4.1	3.2
EV/EBITDA (x)	8.5	7.0	5.4
RoE (x)	7.6	15.0	23.9
RoCE (x)	8.3	9.7	14.1

Shareholding pattern (%)

As On	Jun-17	Mar-17	Jun-16
Promoter	35.0	35.0	35.0
DII	0.0	0.0	0.0
FII	9.9	10.1	10.7
Others	55.1	54.9	54.3

FII Includes depository receipts

Prime Focus

Set to run the show

Aliasgar Shakir

+91 22 3982 5423

aliasgar.shakir@motilaloswal.com

Please click here for Video Link

Set to run the show

Forte in global media services to drive profitable growth

- **Prime Focus Ltd (PFL) is a full-service media player offering creative solutions, including visual effects (VFX), animation, 3D conversion and media-focused ERP solutions, in India and abroad.**
- **The company turned profitable in FY17 post completion of the M&A integration in FY15-16. In our view, the four M&A transactions in the last five years have allowed PFL to become a strong media service player globally, which should drive 15%/18% revenue/EBITDA CAGR over FY17-20E.**
- **One of the top-4 Hollywood VFX service providers, PFL is well placed to benefit from the steady rise in VFX budgets of the top Hollywood movie grossers.**
- **We note that the demons of ~2.8x jump in net debt to INR13.9b and 50% equity dilution over the last five years are now behind. Furthermore, improving EBITDA and lower capex requirement are expected to help generate healthy FCF, improve RoIC to 19% and reduce net debt by ~68% to INR4.5b by FY20.**
- **We thus initiate coverage on PFL with a Buy rating and a target price of INR130 (46% upside), based on SOTP-based valuation, ascribing 10x (industry average) on FY19E EBITDA.**

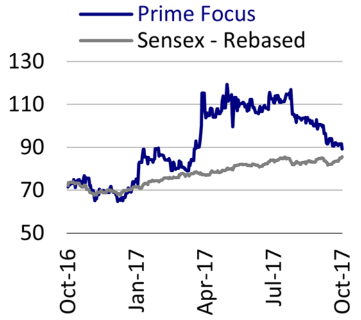
Full-service media player set to run the show

PFL, a full-service media player, has grown its revenue by 10x and EBITDA by 5x over the past ten years. Post five years of strategic M&As (integration completed in FY15-16), the company turned profitable in FY17. We believe M&A has allowed PFL to become a strong player in the media service industry globally, which should drive steady 15% revenue CAGR over FY17-20E to reach INR32.8b. Besides this, the scale benefits and cost synergies, particularly in the Creative segment, should drive 18% EBITDA CAGR to reach INR 7.8b over the same period.

Creative segment – Animating growth

Creative segment, which operates through its 80%-held subsidiary, Prime Focus World (PFW), has significantly enhanced its competitive position post the merger with Double Negative (DNeg), one of the top-4 Hollywood VFX service providers. Enjoying a healthy USD250m order pipeline (v/s USD100m in FY14), Creative segment (77% of revenues in FY17) is expected to exhibit revenue CAGR of 16% over FY17-20E to reach INR26.2b. We note that 90% of the top 25 movie grossers are VFX-heavy (in the last three years), and the budgets for the same continue expanding (from 10% to 25-30% of top 25 movie grossers in last ten years). Thus, Creative segment's target market – Hollywood VFX industry – continues to grow in high-single-digits. The segment's cost synergies (as incremental projects relocate to low-cost centers) should also drive steady margin improvement. We expect EBITDA CAGR of 22% over FY17-20E to reach INR6.4b.

Stock Performance (1-year)



Tech and India FMS to remain steady

Tech business (16% revenue in FY17), which operates through its 74%-held subsidiary, Prime Focus Technology (PFT), offers cloud-based media ERP solutions to global media houses. Notably, the company does not face direct competition from peers in this business. PFT's content digitization endeavor has allowed it to become a dominant player in India, and it has partnered with anchor broadcasters like Star TV. Operating with an order book of ~USD200m, the company is expected to exhibit revenue/EBITDA CAGR of 15%/16% over FY17-20 to reach INR5.3b/INR1.5b. PFT's recent investments in developed markets, breakthrough in Latin America and inherent lumpy revenue growth profile have the potential to drive significantly better-than-expected performance. Its other business, the India Film Management Services (FMS) (7% revenue contribution in FY17), is a dominant pre- and post-production equipment/service provider to the film industry. This business is expected to grow its revenue and EBITDA at 8% and 3%, respectively, over FY17-20E as large production houses turn to captive resources.

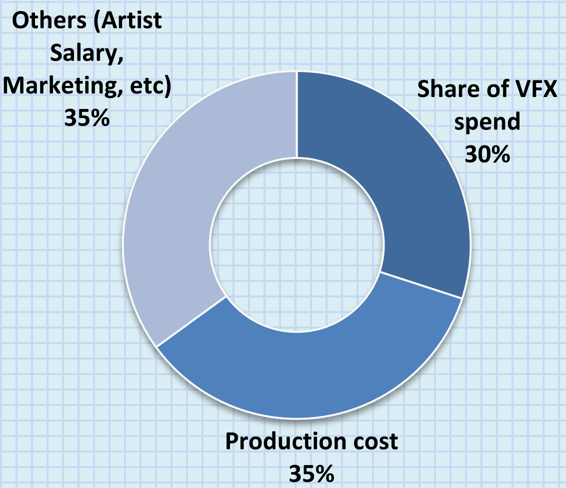
M&A phase behind; expect steady RoCE, FCF improvement

The company underwent 50% equity dilution, and grew gross debt from INR5.4b to INR15.2b over FY12-17. This can be ascribed to the FCCB repayment woes, the four M&A transactions over FY14-16 and also reclassification of INR2.4b preference capital as debt (based on Ind-AS). However, with no further need for M&A, incremental cash flow should be utilized toward debt repayment. Additionally, provisioning of the long-pending INR2b debtors has lowered debtor days (from 130 in FY14 to ~40 in FY17). We expect moderate capex of INR1.75b (7% capex to sales), and improving profitability on a leaner balance sheet should drive RoIC to 19% by FY20. FCF generation (after deducting net interest cost) should increase to INR4.6b in FY20 from INR0.7b in FY17. With cumulative FCF generation of INR12.0b over FY17-20E, the current INR15.2b gross debt is expected to reduce significantly.

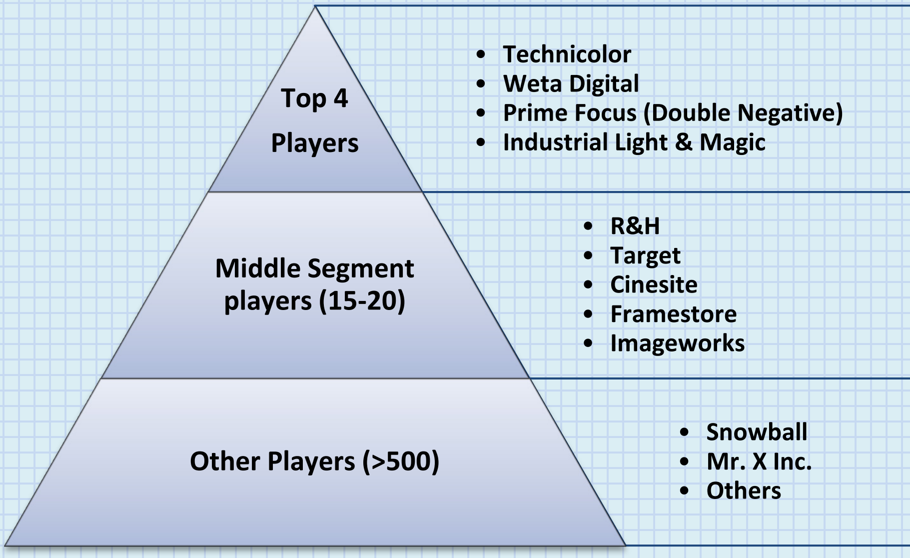
Valuation and view

The stock is trading at adj. P/E of 15.2x and EV/EBITDA of 5.4x on FY19E basis. Using SOTP, we value Creative segment at 10x EV/EBITDA, Tech/Tech-enabled services at 10x EV/EBITDA (industry average) and Indian FMS at 6x EV/EBITDA, arriving at a TP of INR130. The higher valuation multiple for Creative and Tech/Tech-enabled business is attributed to its healthy profit growth and sturdy competitive position in both the businesses. India FMS business also offers steady profitability, but limited growth opportunities – and thus low valuations. We believe its improving return ratios and FCF generation offer strong re-rating potential. We initiate coverage with a **Buy** rating and a target price of INR130, offering 46% upside.

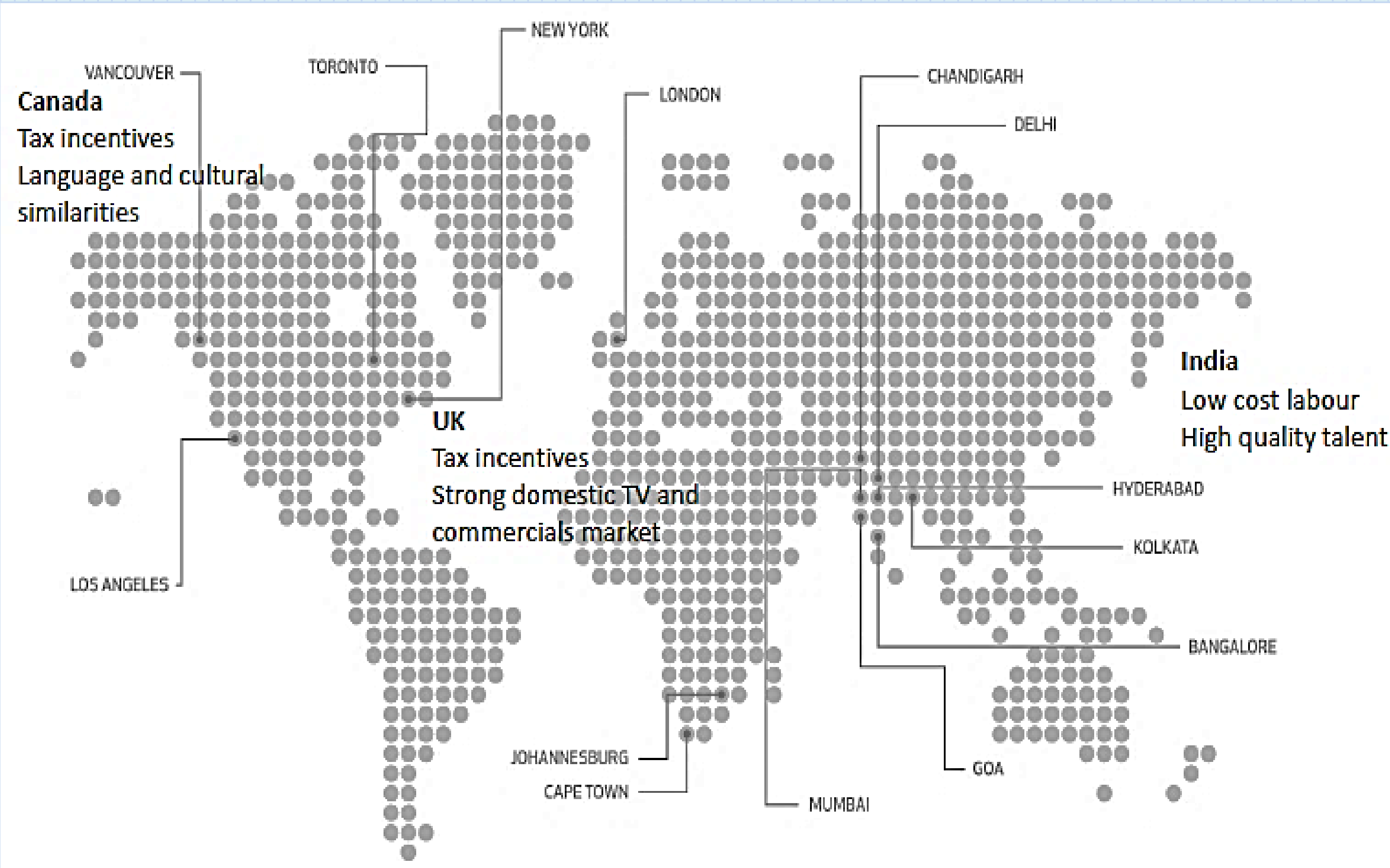
Hollywood's avg. movie budget of top-25 films



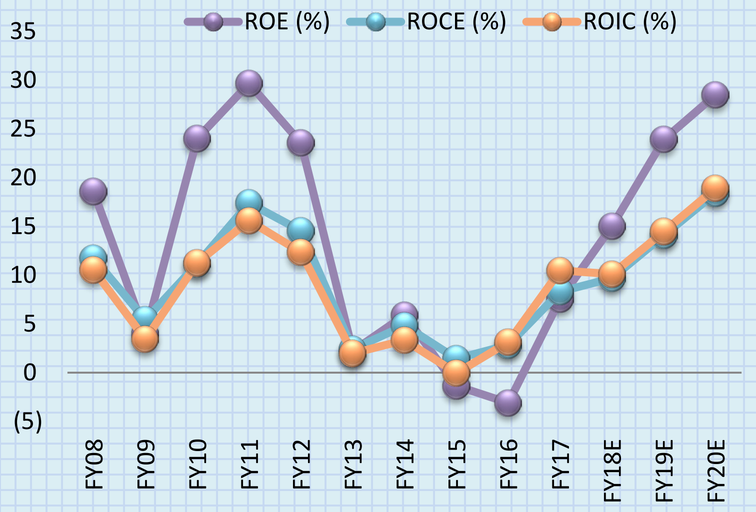
Hierarchy of VFX industry



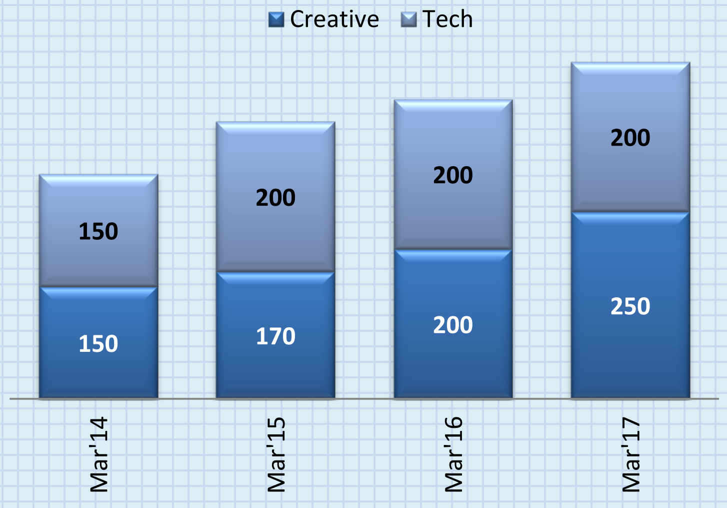
Maximizing global efficiencies



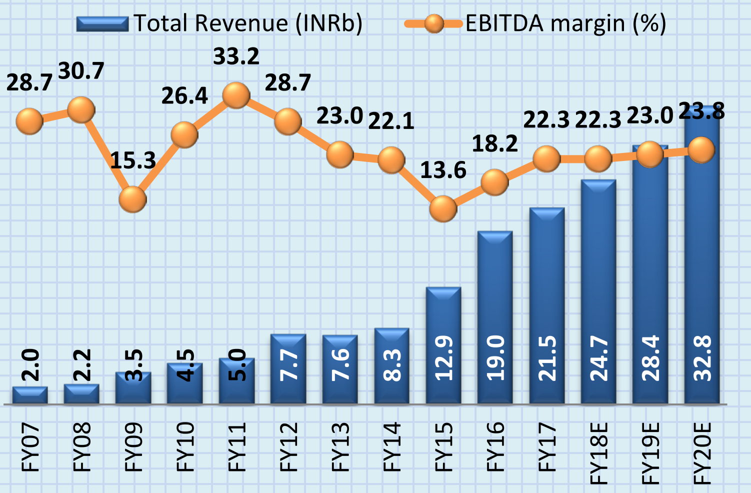
Resurgence in returns



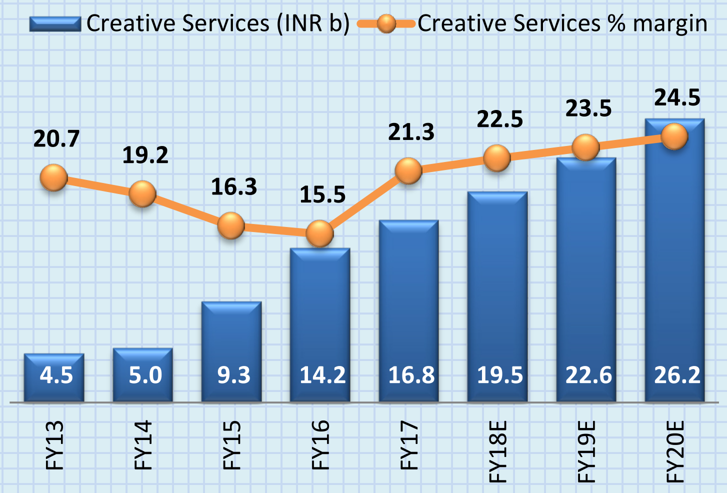
Strong order book (USD m)



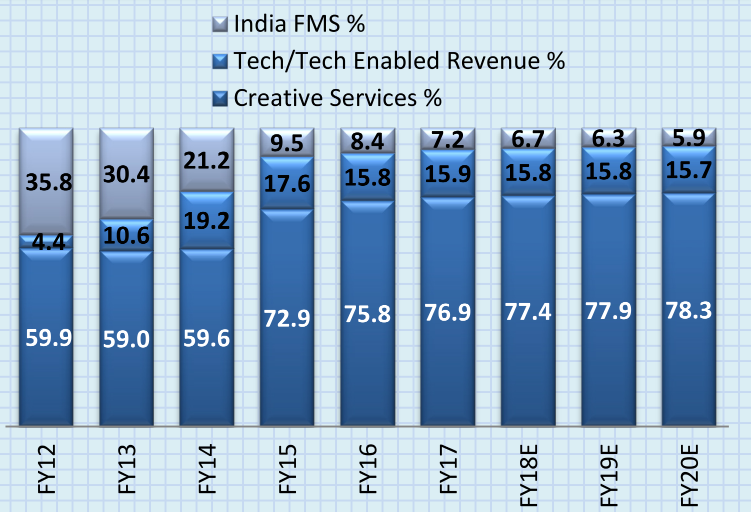
Revenue and EBITDA margin to increase steadily over FY17-20



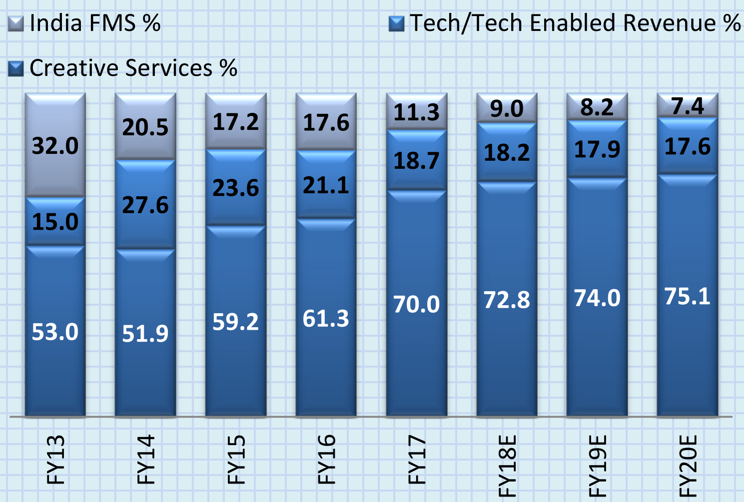
Creative Services to steer growth



Segment-wise contribution to revenue



Segment-wise contribution to EBITDA



Turns profitable

Full-service media solution provider – 18% EBITDA CAGR potential over FY17-20E

- **PFL is a strong media services player offering creative (visual effects, 3D conversion, animation) and technology (media ERP, cloud-enabled services) services to Indian and global film studios and broadcasting companies.**
- **Over the next three years (FY17-20), PFL is well poised to witness strong revenue CAGR of 15% to reach INR32.8b and EBITDA CAGR of 18% to reach INR7.8b.**
- **PFL has delivered robust growth over the last six years, reaching revenues of INR21.5b in FY17 (4.3x of FY11), led by its organic and inorganic growth strategies.**

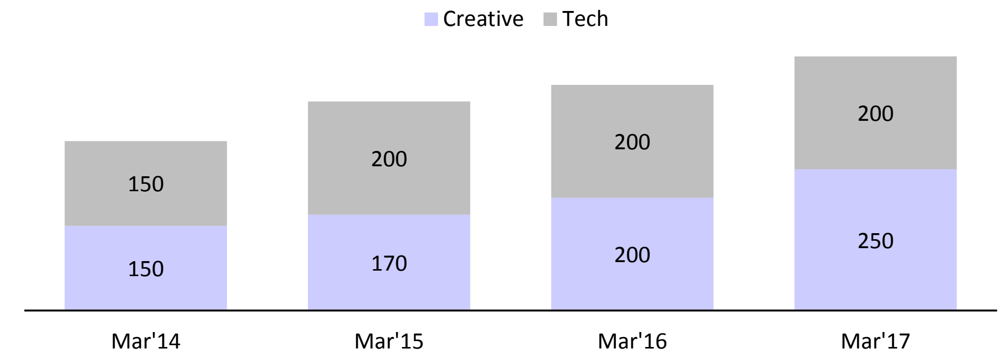
Outlook supported by margin-led growth in Creative segment

PFL operates under three businesses: Creative services (visual effects, 3D conversion and animation), Technology (media ERP, cloud-enabled services) and India FMS (production, post-production and creative services).

The company has delivered robust growth over the last six years, reaching revenue of INR21.5b in FY17 (4.3x of FY11), led by its strategies (both organic/inorganic) to strengthen its comprehensive bouquet of services to large studios and broadcasters in India and globally. Notably, EBITDA and PAT jumped 2.9x and 1.7x over FY11-17. Over the past ten years, PFL has made deep inroads and built a strong competitive position in the Indian and global media service industry, becoming one of the top four VFX providers for premium Hollywood studios. PFL derives 80%+ revenues from overseas, servicing top Hollywood studios, broadcasters and M&E companies.

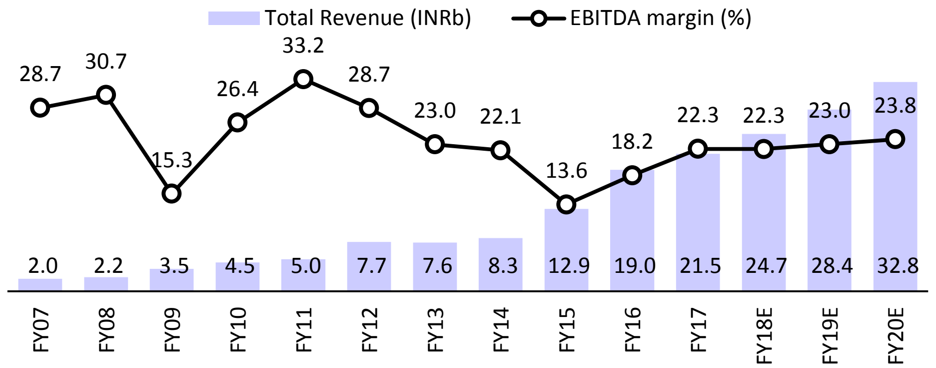
The acquisition of low-margin DNeg – a Hollywood-based VFX player – led to a net loss in FY15 and FY16. However, the company exhibited a successful turnaround with adjusted PBT of INR519m in FY17, backed by a large order book with strong visibility, as well as increasing delivery from low-cost centers. Over the next three years (FY17-20), PFL is well poised to witness strong revenue CAGR of 15% to reach INR32.8b, and EBITDA CAGR of 18% to reach INR7.8b. Creative business, which has fortified its relationships with some marquee clients over the last 2-3 years, should allow it to take a high share of the premium market.

Exhibit 1: Strong order book (USD m)



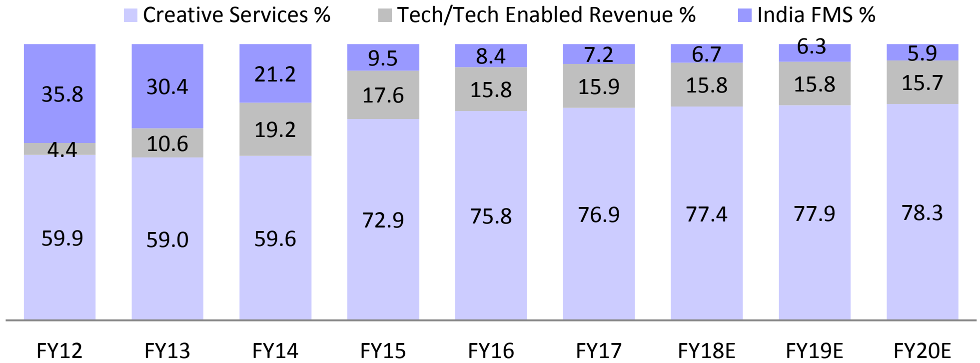
Source: MOSL, Company

Exhibit 2: Revenue and EBITDA margin to increase steadily over FY17-20



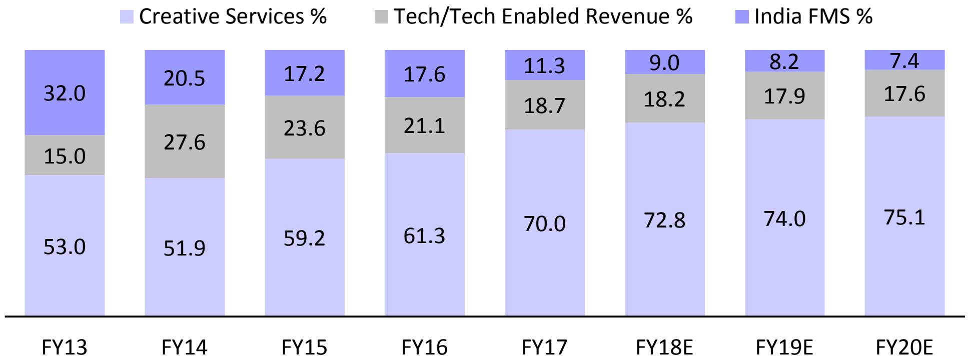
Source: MOSL, Company

Exhibit 3: Segment-wise contribution to revenue



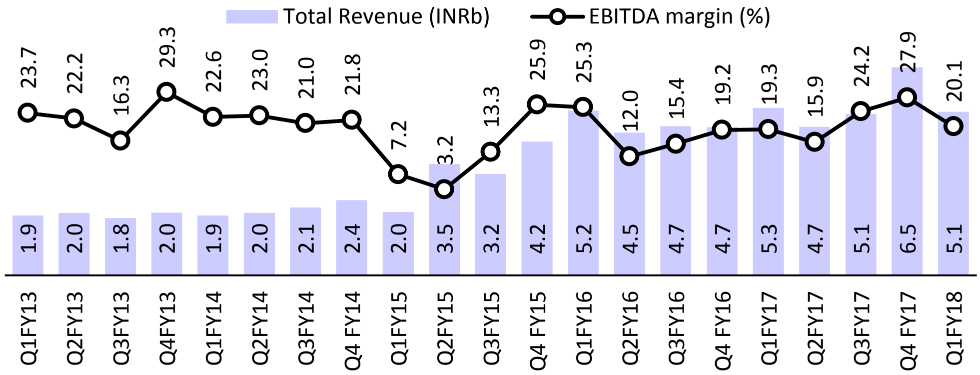
Source: MOSL, Company

Exhibit 4: Segment-wise contribution to EBITDA



Source: MOSL, Company

Exhibit 5: Quarterly trend in revenue and margins



Source: MOSL, Company

Creative Services – a strong driver of profitability

Among the top four Hollywood VFX service providers in a stable market

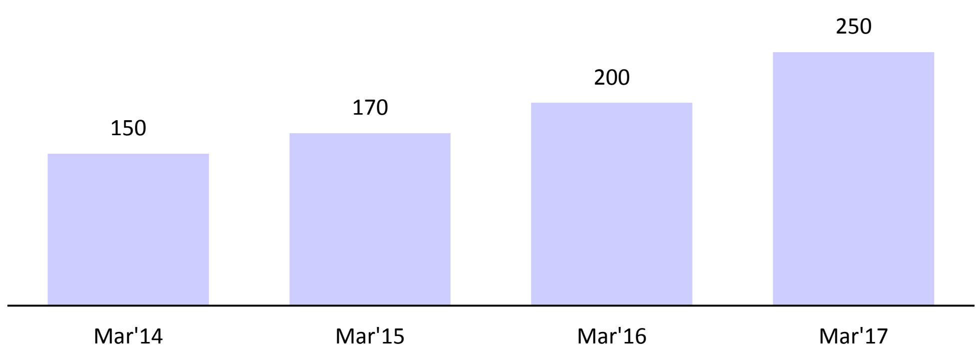
- **Over FY17-20, the Creative segment is expected to witness 16% revenue CAGR to INR26.2b, and 22% EBITDA CAGR to INR6.4b on the back of its healthy USD400m order book. The merger with DNeg and Gener8 has helped PFW (the company operates in this segment through this subsidiary) create a strong competitive position in a sticky market.**
- **The ~USD2.5-3b global VFX industry has grown at 10% CAGR over the last five years. With 90% of the top-25 movie grossers being VFX-heavy and the budgets for special effects increasing from 10% to 20-25% of the top-25 movie grossers in the last 10 years, the market potential appears promising.**
- **Return on investment for the top-25 Hollywood movie grossers is as high as 10x. Thus, the six 'major' film studios, which produce/distribute 75% of the top-25 Hollywood grossers, have a very concentrated VFX provider base, given its high importance in a movie's success. PFW's break into these top four players is a big success, in our view. Furthermore, we note that 19 of the top-25 Hollywood films were released in the 3D format, which indicates growing demand for 3D content.**

Creative Services – gaining share in a steadily growing market

Creative Service, which operates under the company's subsidiary Prime Focus World (PFW), is among the top four specialized service providers, catering to the marquee Hollywood studios that produce high-end VFX, 3D and animation-based movies. The company has won two Oscar awards since the merger (three overall)– bagged its second consecutive VFX Oscar for Ex Machina, following last year's win for Interstellar.

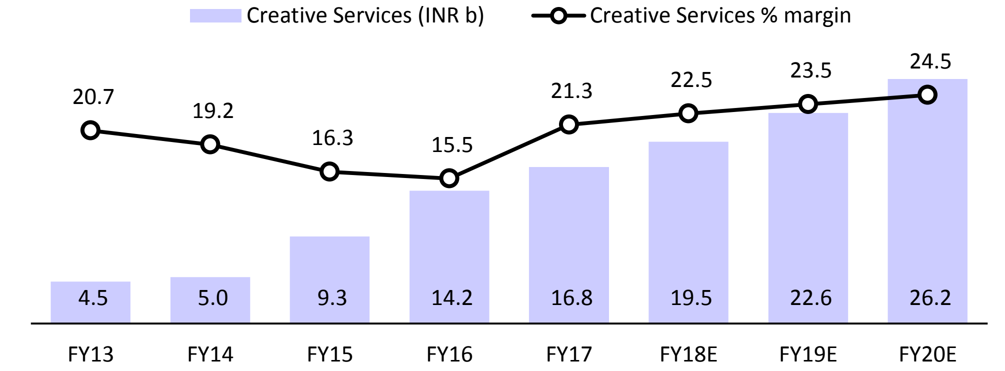
Creative Services' revenue stood at INR16.8b in FY17 (up 3.6x over FY12-17), with an order book of over USD250m (up from ~USD100m in 2014). Creative segment now contributes ~77% of revenue, with EBITDA margin of 21.3% as of FY17. Of the total Creative revenue, USD175m comes from VFX business and USD70m from 3D conversion business. We believe Creative segment has the potential to grow revenues at a steady rate of 16%, led by healthy industry growth of ~10% and the increased share of premium VFX projects (attributed to its higher bandwidth and cost synergy derived from its low-cost India center). Subsequently, we believe PFL enjoys huge scale benefits, and has the potential to improve EBITDA margin by 300-350bp from 21.3% in FY17.

Exhibit 6: Strong order book (USD m)



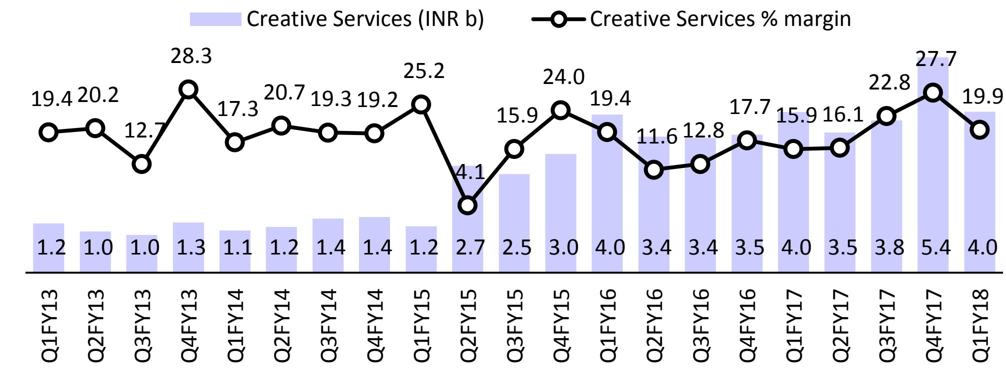
Source: MOSL, Company

Exhibit 7: Creative Services to steer growth



Source: MOSL, Company

Exhibit 8: Quarterly trend in revenue and margins



Source: MOSL, Company

A leading global VFX player enjoying top client relationships

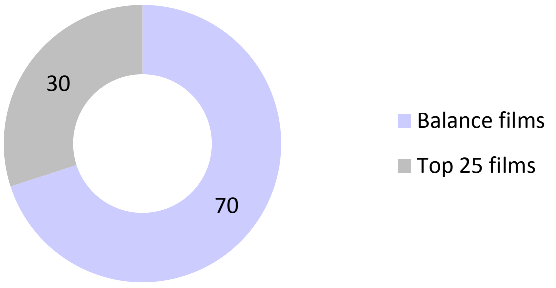
PFW works closely and has deepened its engagement with leading Hollywood clients like Warner Bros, Disney, Universal Studios, Paramount, Sony, Twentieth Century Fox and Legendary Pictures. In 2014, PFW merged its operations with US-based DNeg – a premiere VFX player having top-tier relationships with large studios. This has provided a major facelift to its competitive standing in the US post-production market, and also helped it become one of the top four VFX service providers (with ~25-30% market share) in the premium VFX market (top-25 grossing Hollywood movies).

Exhibit 9: Hollywood VFX market (USDm)

Premium movie budget	150
VFX budget (~25% of the total movie budget)	38
Top 25 movies' VFX share	938
VFX budget (Top 25 movies) (%)	30%
Total US Film VFX market	3,125
Top 25 movies' VFX share	938
Top 4 service providers share (out of top 25 movies' VFX budget) (%)	60%
Top 4 service providers share	563
Prime Focus World VFX revenue	**175**
Prime Focus World VFX market share (Out of top 25 movies' VFX share) (%)	**19%**

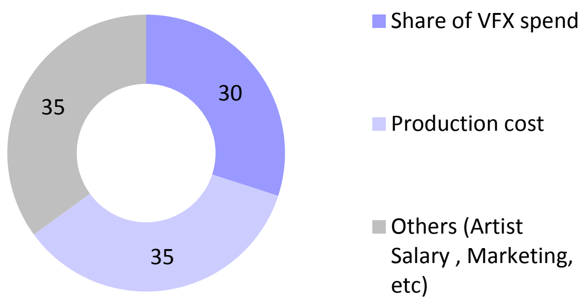
Source: Industry, MOSL

Exhibit 10: Top-25 films comprise ~30% of production budget for total films (%)



Source: Industry, MOSL

Exhibit 11: Hollywood's avg. movie budget of top25 film (%)



Source: Industry, MOSL

A sticky service provider in a concentrated client market

The global VFX industry is highly fragmented, with a long tail of over 500 firms eying for a share of the pie. However, the top production houses in the US have a sticky and highly concentrated list of service providers. Given the high return potential of the top-25 Hollywood movies (10x returns to investment), VFX directors/supervisors are highly quality-conscious and very selective in setting the service provider network. Thus, there is a clear segmentation among players, with key large players doing around two thirds of the top 25 movies, and mid- to small-level players doing the rest.

PFW has emerged as one of the top four global VFX players post the DNeg merger. Its strategic partnership with Gener8 further augments its leading position in the Hollywood stereo conversion (3D Conversion) segment, wherein both the companies enjoy a combined share of 30%.

Exhibit 12: VFX industry landscape

	Revenue (USDm)	Player	Control of market (%)
Top 4	> USD 150m	Industrial Light & Magic, Technicolor, PFW, Weta Digital	< 25-30%
Mid-size firms	USD 50 - 150m	Sony Imageworks, Deluxe Entertainment, Cinesite, Framestore, Digital Domain	< 20-25%
New and small size firms	< USD50m	Other fringe players	Balance 45-55%

Source: Industry, MOSL

Worked on Hollywood's highest grossers

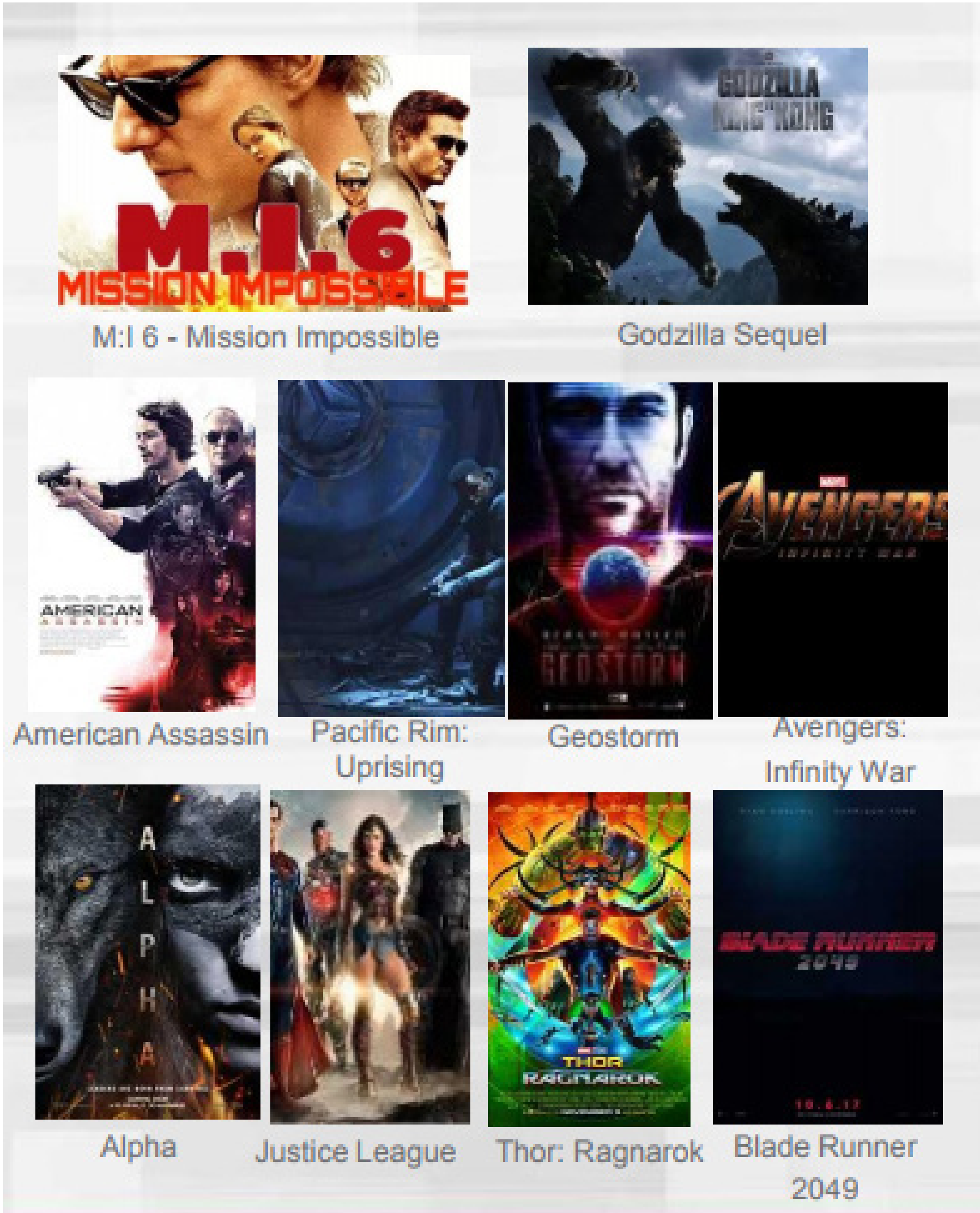
PFW has made its way into the list of tier-1 players, bagging high-end, high-value VFX projects following the acquisition of DNeg. PFW has worked on numerous VFX projects, including four of the ten highest-grossing movies of 2016 in Hollywood. It has been consistently increasing share in the top-25 revenue grossers in the industry. The company has won three Oscar awards since the merger – bagged its second consecutive VFX Oscar for Ex Machina, following last year's win for Interstellar.

Healthy order visibility, bundled offerings to drive growth

Creative segment enjoys consistent revenues, led by a stable and long-term order book of VFX projects. In VFX, an average project fetches revenue in the range of USD5-40m and is executed over 6-9+ months. PFW has increased visibility on its order book, with over USD250m of project work to be executed over the next 9-12 months. The company is also continuously increasing cross-sell via its bundled offering (VFX and 3D conversion services).

In FY16, PFL offered bundled VFX and 3D offerings to blockbuster movies like 'Captain America: Civil War' (USD1,151m), 'Batman v Superman: Dawn of Justice' (USD872m), 'Alice Through The Looking Glass', 'In The Heart Of The Sea' and 'The Hunger Games: Mockingjay Part 2'. With steady 10-15% industry growth, deeper inroads (led by bundling offerings) and a healthy order book, we expect revenue CAGR of 16% over FY17-20 to reach INR26.2b.

Exhibit 13: Robust order book of USD250m+



Source: MOSL, Company

Double Negative and Gener8 acquisition help Creative find place in top VFX service provider list

Following the merger of PFW with DNeg, the Creative segment got a major facelift – in 2014 and 2015, the company undertook the following key transformational transactions:

- In June 2014, PFW merged with DNeg, creating one of the largest independent tier-I VFX services firm in Hollywood. The merger has a) provided much-needed entry into the list of top-tier VFX providers of large Hollywood studios, b) positioned the company closer to the customer and c) provided cross-sell opportunities of 3D conversion and VFX services.
- The acquisition of Gener8's 3D business (a global leader in 3D conversion market) further improved its leading position. The two companies together enjoy a market share of ~30% in the Hollywood stereo conversion market.

With the help of these two major transactions, Creative segment grew from INR5b in FY14 to INR16.8b in FY17 (via both organic as well as inorganic routes), implying 50% CAGR.

VFX market turning favorable for large service providers

VFX-heavy global box office grossers driving industry growth

The VFX film market globally is estimated at USD2.5-3b, growing at 10% CAGR over the last five years. The market is expected to continue growing at a steady pace, as VFX has become an integral part of the film production process. The point to note is that 90% of the top-25 grossers in the last three years were VFX-heavy movies. This indicates that large studios would continue focusing on VFX-heavy movies to drive collections.

Exhibit 14: Top grossers

2014	USD m	2015	USD m	2016	USD m
Transformers: Age of Extinction	1104	Star Wars: The Force Awakens	2068	Captain America: Civil War	1153
The Hobbit: The battle of the five armies	956	Jurassic World	1670	Rouge One: A star Wars Story	1050
Guardians of the Galaxy	773	Furious 7	1516	Finding Dory	1028
Maleficient	758	Avengers: Age of Ultron	1405	Zootopia	1024
The Hunger Games: Mockingjay - Part 1	755	Minions	1159	The Jungle Book (2016)	967
X-men: Days of Future Past	748	Spectre	881	The Secret Life of pets	876
Captain America: The Winter Soldier	714	Inside Out	858	Batman v Superman: Dawn of Justice	873
Dawn of the Planet of the Apes	711	Mission Impossible - Rouge Nation	682	Fantastic Beasts and Where to find them	811
The Amazing Spider-Man 2	709	The Hunger Games: Mockingjay - Part 2	653	Deadpool	783
Interstellar	675	The Martian	630	Suicide Squad	746

Note: Highlighted areas in the table represent projects executed by PFL Source: Industry, MOSL

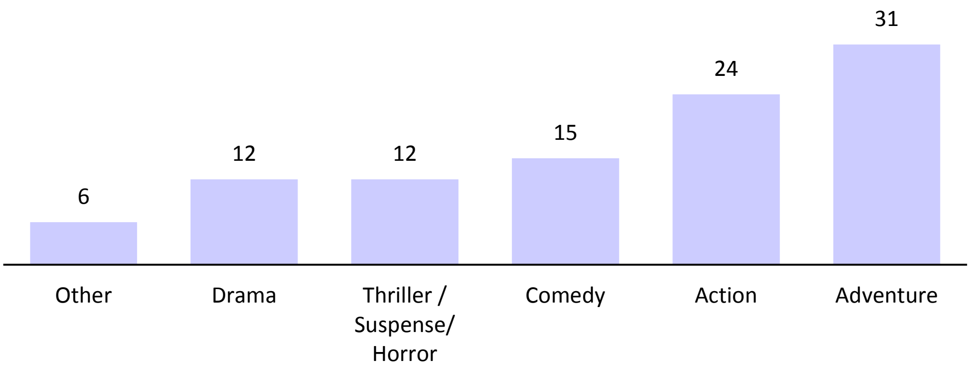
Economics of VFX budget

Typically, out of a movie budget of USD150-200m, i) 25-30% is spent on VFX (10 years back, it was 10% of the budget; now some of the movies spend even about 60-70%); ii) one-third of revenues are toward production cost, artist salary, shoot and logistics; and iii) one-fourth of the cost is toward marketing, promotion (i.e. USD30-50m).

The production house may bifurcate its USD50-70m VFX budget based on job premiumization (USD20-30m worth of job done by 1-2 companies, remaining USD30-40m by 5-7 companies). PFW can generate higher revenues by scaling up the value chain and taking a higher share of the premium job.

Over the last few years, VFX genres like action and adventure are established as leading genres in the US film industry, together contributing over 50% of the global box office collections. VFX-heavy movies in the last 5-10 years have been the top grossers in the year of their release, generating over 5-10x return on investments. One of the key cause and effect factors that has led to its high grossing is the Hollywood's global content, which caters to wider population, not restricting to a particular culture and ethos. This is also a key reason why most of the new Hollywood productions are increasingly shifting focus to a globally targeted storyline.

Exhibit 15: Action & adventure comprising ~50% of global box office collection (%)

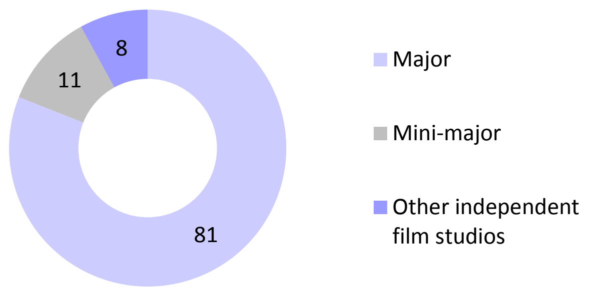


Source: Industry, MOSL

Ruled by major and mini major studios

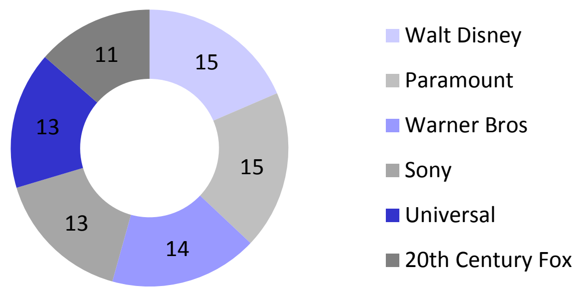
Major and mini major studios account for a large proportion of the US film budget. Six major studios – Walt Disney, Warner Bros, Fox Entertainment, Universal Studios, Paramount and Sony Picture Motions – are involved in films that make-up more than 75% of the overall production budget, either as a producer, co-producer or distributor for the film. The prominent big film production companies referred as mini major studios include Lions Gate, STC Entertainment, and MGM Holdings, among others. Most big-budget movies every year are linked to one or combination of majors. Many movies may not be directly produced by a major production house, but being a key financer, it may be responsible and deeply involved in the selection of service provider and marketing of the project. PFW is gaining strong competitive edge by making inroads in top studios.

Exhibit 16: Share of studios for top 500 film production budget (2009-11) (%)



Source: Industry, MOSL

Exhibit 17: Share among majors (2009-11) (%)



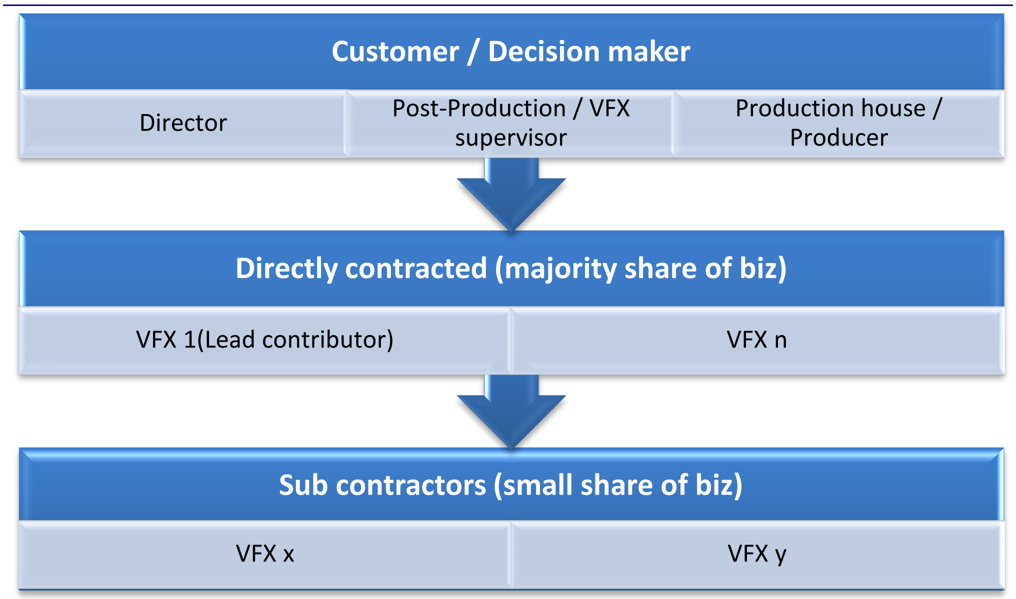
Source: Industry, MOSL

Lead VFX service providers take the premium job

Typically, in a VFX project, the premium job will be taken up by the lead VFX service provider, which will be directly contracted to manage the entire deliverable on the project, with the support of 2-3 more VFX players. This is done either based on a player's specialization in certain library of work for select characters/shots. De-risking the work is the main intension for the bifurcation.

Higher share of project work will be given to the lead VFX player. Low-skilled jobs are usually sub-contracted to smaller VFX players, largely to manage timelines or complete emergency work. PFL has gradually transformed itself from a VFX support provider to a lead service provider in many of the top-25 grossers. This has progressively improved its revenue share and profitability.

Exhibit 18: VFX buying process



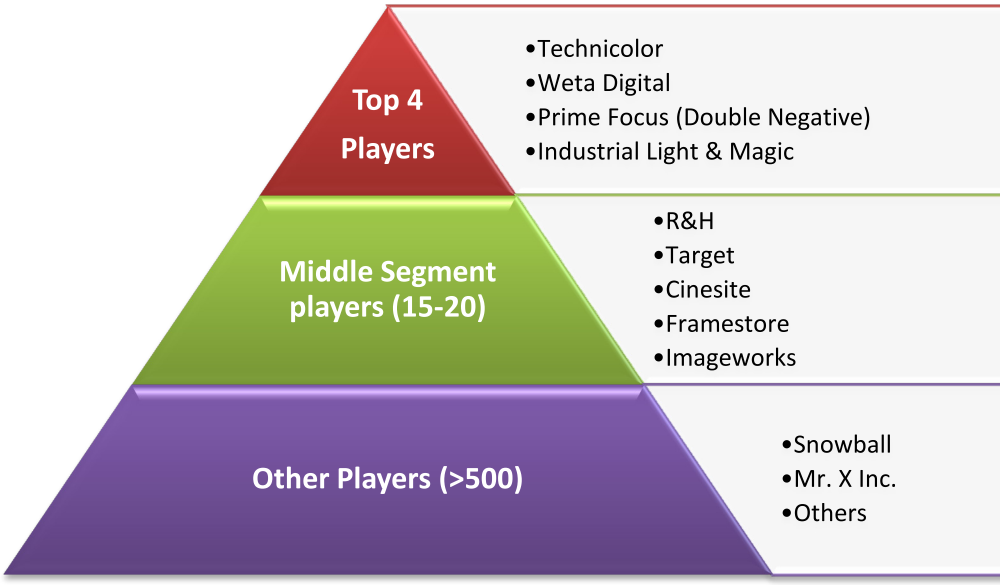
Source Industry, MOSL

Concentrated service provider network

- **Top 4-5 players operate as lead VFX service provider**
  Top and mid-tier VFX players get majority of the work from major and mini-major studios. The top 4-5 VFX operators include ILM, Weta, Double Negative (now Prime Focus) and Technicolor – they are the lead players for specific studios, mainly because of their existing strong relationships and established capabilities. Among these four, only Technicolor and Prime Focus are independent players, while ILM is owned by Disney and Weta is backed by renowned producer/director Peter Jackson. Typically, independent visual effect providers are preferred by studios, given their high skill nature of business and concerns around conflict of interest. These top four players have been involved in about two thirds of the top 25 VFX-heavy movies over the last five years. For instance, ILM is the lead contributor for Pirates of the Caribbean, Technicolor for Harry Potter and Avatar, Double Negative for '2012', and Weta for X-Men.

- **2nd tier players manage specialized work**
  Certain VFX providers specialize in select characters or scenes hired by major and mini-majors for their library. Some of the key players are R&H, Framestore, Image Works, Deluxe, Cinesite, and Point 360, among others. They usually play a supporting role along with top players in executing large VFX projects. For instance, R&H worked as a support VFX service provider for The Wolf Man, Framestore for Prince of Persia, and Image Works for Green Lantern. A long tail of over 500 small VFX service providers works largely for TV shows and commercial ads, including a few in-house VFX set-ups of production houses. They typically work on low-budget films or as a support with certain top players.

Exhibit 19: Hierarchy of VFX industry



Source: Industry, MOSL

Quality of service – key criteria to decide VFX partners

- **Relationship, talent**
  VFX is a highly relationship-based business. Strong association with creative personnel, editors and VFX experts in studios drives the business. Given the critical nature of the business and potential to make 5-10x return on the cost, the creative heads from studios are very particular about the quality of work.

- **Project, pipeline management**
  Typically, one of the key ways in getting the highest share of VFX business in a project or to be a lead VFX player is to be part of the project during the story boarding and ensure it is integrated with the entire film making. To ensure timely delivery, the lead VFX operator coordinates with other VFX players and sub-contractors tied with the project.

- **Technology**
  Proprietary workflow management to ensure seamless multi-located delivery, and access to latest VFX technology are key.

- **Pricing**
  Pricing is the last priority in the VFX business and is not the key value proposition in getting fresh projects. However, given the increasing pricing pressures, players have started evaluating low-cost avenues like the UK, Canada (tax incentives), India, China, Philippines (low labor cost).

Exhibit 20: Key buying criteria

Talent
- Creative individual & editors
- VFX experts

Project / Pipeline Mgmt
- End-to-end support
- Deliver on time

Technology
- Latest technology

Price

Source: Industry, MOSL

Growing demand for 3D content led by higher-ticket revenues

Biggest advantages of 3D movies are: (i) it has higher-ticket pricing due to its superior viewing experience, and (ii) there is limited piracy risk due to unavailability of 3D content.

3D box office collection in the US/Canada was USD1.6b in 2016, accounting for 14% of total box office. The number of 3D film releases in the US and Canada was 52 in 2016 v/s 40 in 2015. In 2016, 9 out of the top 10 and 19 out of top 25 films (based on gross collection) were released in 3D (v/s 6 and 14, respectively, in 2015).

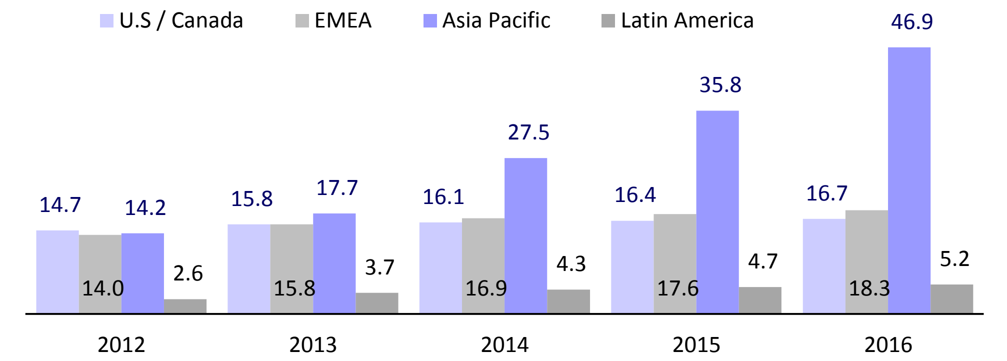
Exhibit 21: 19 of top 25 films released in 3D (2016)

Sr. No	Movie	3D
1	Finding Dory	✓
2	ouge One: A star Wars Story	✓
3	Captain America: Civil War	✓
4	The Secret Life of pets	✓
5	The Jungle Book (2016)	✓
6	Deadpool	
7	Zootopia	✓
8	Batman v Superman: Dawn of Justice	✓
9	Suicide Squad	✓
10	Star Wars: The Force Awakens	✓
11	octor Strange	✓
12	Fantastic Beasts and Where to find them	✓
13	Moana	✓
14	The Revenant	
15	Jason Bourne	
16	Star Trek Beyond	✓
17	X-Men: Apocalypse	✓
18	Sing	✓
19	Trolls	✓
20	Kung Fu Panda 3	✓
21	Ghostbusters	✓
22	Central Intelligence	
23	The Legend of Tarzan	✓
24	Sully	
25	Bad Moms	

Source: MPAA Theatrical Market Statistics 2016, MOSL

In 2016, global growth in digital 3D screens was 17% v/s 15% in 2015. The global proportion of 3D digital screens increased to 56% of all digital screens. Asia-Pacific has the highest proportion of 3D digital screens at 78%.

Exhibit 22: Worldwide digital 3D screens ('000)



Source: MPAA Theatrical Market Statistics 2016, MOSL

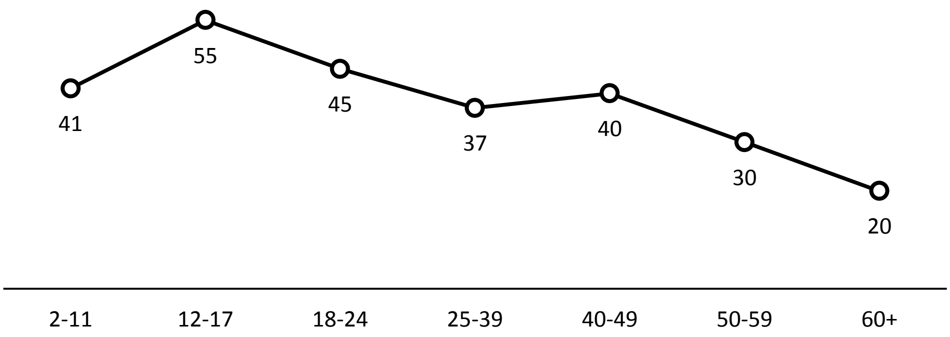
3D market steadily growing

3D movies account for over 15-20% of the US box office collections. The total market potential for 3D films is in the range of 55-65 movies annually. On average, one 3D film gets released each week, with some potential upside during the holiday season.

Penetration of 3D screens has increased sustainably over the past few years. Around 100 films each year have a budget of over USD30m, of which a majority are of action and adventure genre, which can be released in 3D.

Growth in 3D has been driven by the launch of new and existing titles by major production houses. Over 50% of the 3D films are released by the major film studios; over one third of these are animation movies, which are easier to be made in 3D while in production.

Exhibit 23: Moviegoers as % of population by age (2016)



Source: MPAA Theatrical Market Statistics 2016, MOSL

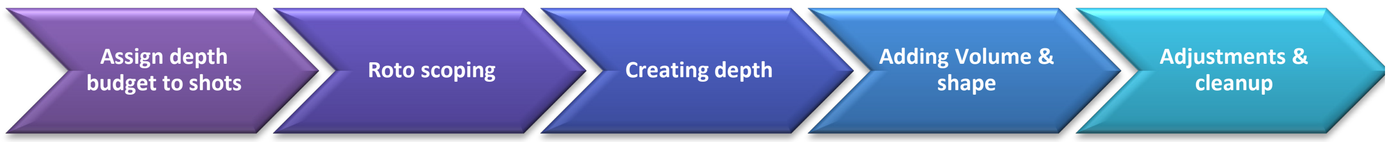
3D conversion a preferred route v/s native 3D photography

There are two competing processes: 2D to 3D conversion, and 3D photography.

Conversion from 2D to 3D is the preferred route as it provides the option of shooting with standard equipment, and provides flexibility to adjust the depth and volume of each object in the scene, making it easy to handle.

On the contrary, 3D photography requires lot of infrastructure, time and expertise, making it more complex procedure. The key reason that goes in favor of native 3D photography is that complex 3D scenes like smoke, reflections and rain can be better captured in the stereo images format.

Exhibit 24: 2D-3D conversion process



- Defining the output
- Done in presence of director / producer

- Accounts for major chunk of the entire process

- Done in presence of director

- Connecting multiple images at various depths together

- Reconstruction of areas not filled by stereo generator

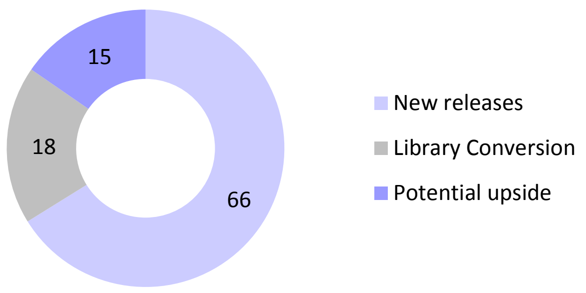
Source: Industry, MOSL

2D to 3D conversion – a concentrated market

2D to 3D conversion is largely a two-player market (accounting for 97% of industry revenue), with PFL holding ~50% market share, followed by Legend (~47%) and others (~3%).

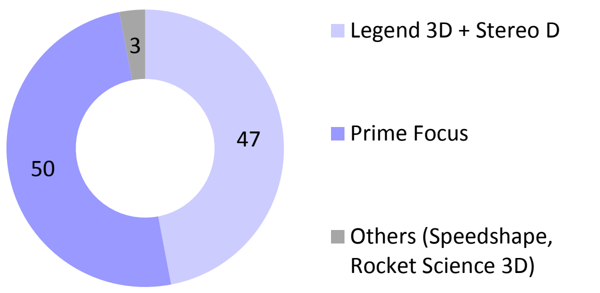
PFL, which uses its own in-house technology in 3D called 'View D', acquired Gener8, one of the leading 3D players, to strengthen its foothold in the market.

Exhibit 25: Share of 3D films (%, US production)



Source: Industry, MOSL

Exhibit 26: 2D-3D conversion market share (%)



Source: Industry, MOSL, Company

Margin-led growth in Creative Services

Outsourcing to drive margins

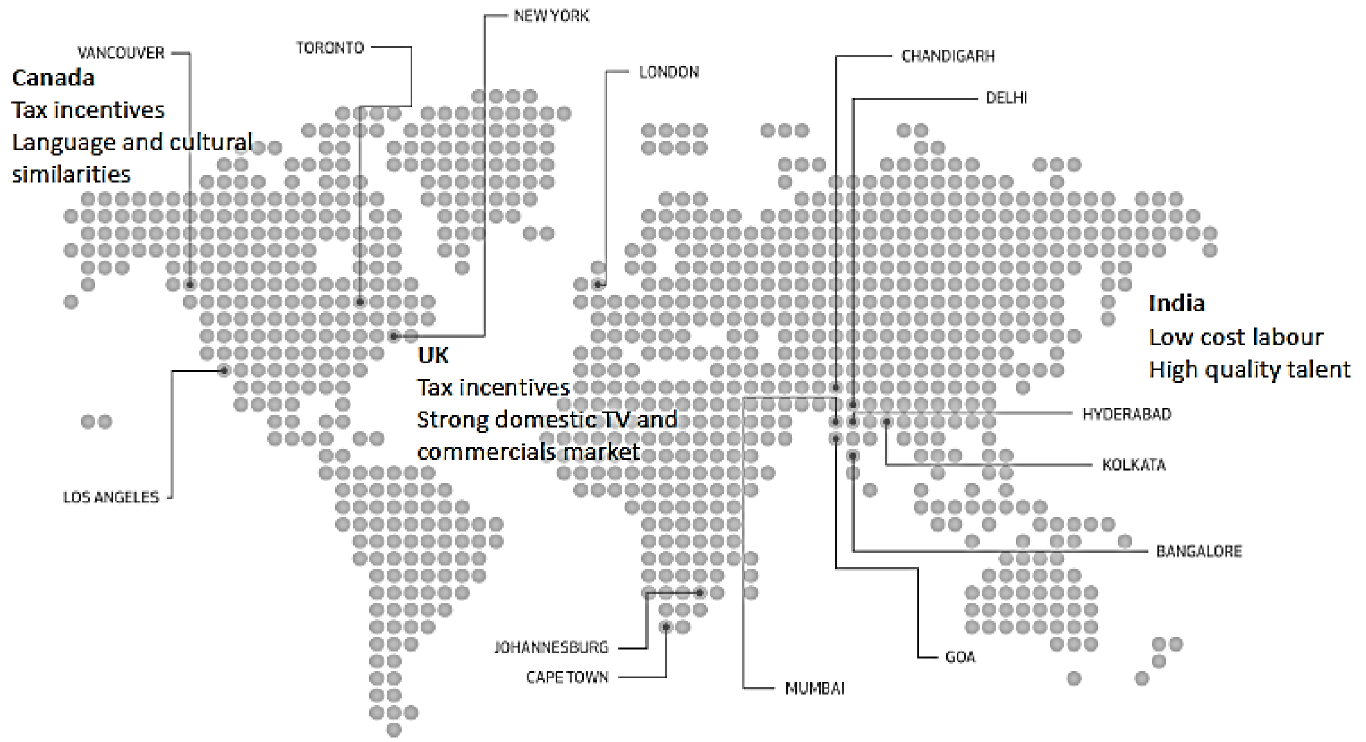
Creative segment's global delivery model of 22 offices in all major content markets with 8,000+ workforce facilitates rapid scaling, execution and high profitability by sharing work across lower-cost regions. This has enabled steady improvement in EBITDA margin from mid-teens in FY15 to 21.3% in FY17, and ~10% above range of other VFX providers operating from the developed regions.

Further, its higher content delivery from India should drive EBITDA margin further closer to 30%. We expect the Creative segment to drive 450-500bp EBITDA margin improvement reaching 26% by FY20.

Creative segment's extensive network helps to maximize global efficiencies such as low-cost skilled labor, and other economic factors such as tax breaks and low trade tariffs. For example:

- The US – Largest Hollywood market, HQs of larger M&E players, sales, client engagement, TV content production and VFX
- Canada – Tax incentives, cultural synergy
- The UK – Tax incentives, local TV and commercial market, leading to higher utilization
- India – low-cost skilled labor

Exhibit 27: Maximizing global efficiencies



Source: MOSL, Company

Most of the VFX players have been shifting their base to cost-efficient locations in a bid to improve margins. For instance, TechniColor started a base in Bangalore with 500 people in five years. This is still significantly lower than PFL's scale of about 5,500 people in India.

Exhibit 28: Peers mostly operate from local offices (contrary to PFL)

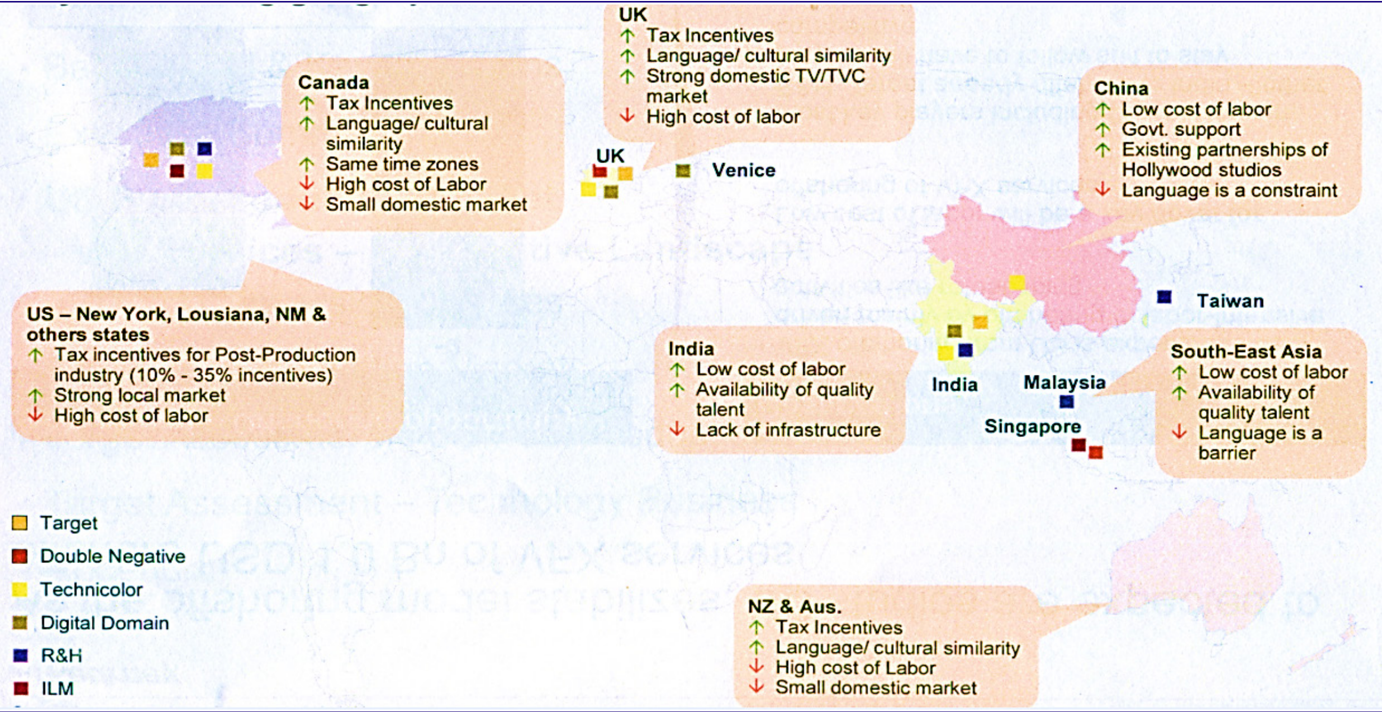
Company	No of offices	Locations	Comments
Industrial Light & Magic	4	San Francisco, Singapore, Vancouver & London	NA
Technicolor	NA	Present in 32 Countries	Operating at EBITDA margin of 7%
Weta Digital	1	New Zealand	NA
Digital Domain	2	Los Angeles & Vancouver	Posted de-growth and losses of USD23m in 2015
Sony Imageworks	2	Vancouver & Culver City	NA

Source: MOSL, Company

Offshoring trends to be beneficial for India

VFX companies operate on wafer-thin, low-single-digit profit margins. Given the volatile nature of the movie business, large studios, despite being quality-conscious, are unwilling to increase their cost budgets due to uncertainty in profitability. This leaves limited room for any production delay, which makes it difficult to accommodate high operating costs, including employee cost. High tax benefits in destinations like the UK and Canada have made London and Vancouver as major destinations for post-production activities. Companies like DNeg (led by Prime Focus) and Technicolor have used labor-intensive destinations like India, Korea and Philippines, operating at 60-70% lower costs.

Exhibit 29: Key offshoring geographies

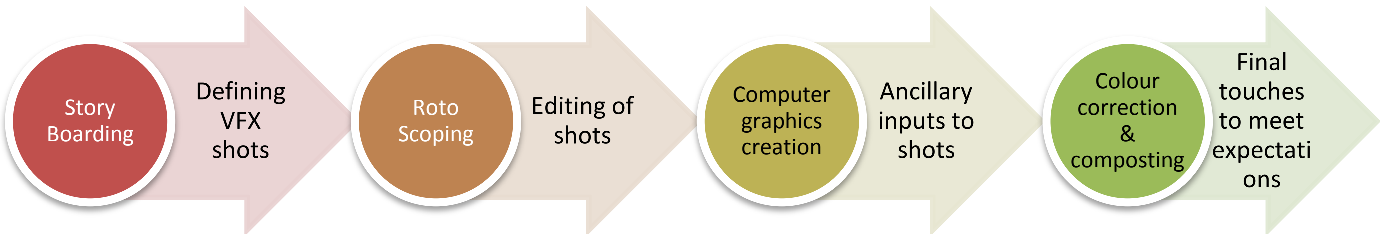


Source: Industry, MOSL

Low-skilled process shifted to cost-effective regions

In a typical VFX activity map, low-skilled, labor-intensive activity with limited creativity requirements can be outsourced to low-priced regions (e.g. Rotoscoping, which largely involves digital altercation of scenes already shot, cutting and cropping of images, is usually offshored). Similarly, parts of computer graphics creation like adding non-live pictures to shots (like fire, smoke, water, lights) and color/surface details to scenes can be offshored, while complex shots can be done onshore in presence of the director and photography head.

Exhibit 30: VFX process flow



Source: Industry, MOSL

Limited risk of competition from low-cost region players

Existing players are driving cost efficiencies through offshoring; however, given that quality and relationships take priority over pricing gains, smaller players from low-cost regions have had limited success, and thus, do not pose threat to the existing players.

Tech/Tech-enabled services – to remain steady

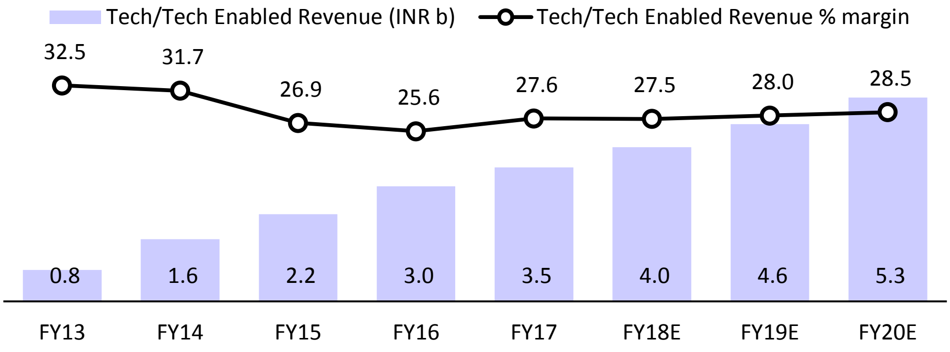
Dedicated media ERP solution provider

- **The Tech/Tech enabled segment is expected to grow revenue and EBITDA at 15% and 16% CAGR, respectively, over FY17-20E.**
- **PFT garners 65% revenues from India. The strategic acquisition of DAX (Mar-14) helped PFT expand its portfolio as well as global footprint.This, coupled with recent senior management hiring, offers strong growth potential in the overseas market.**

Uniquely positioned to offer customized ERP solutions to media firms

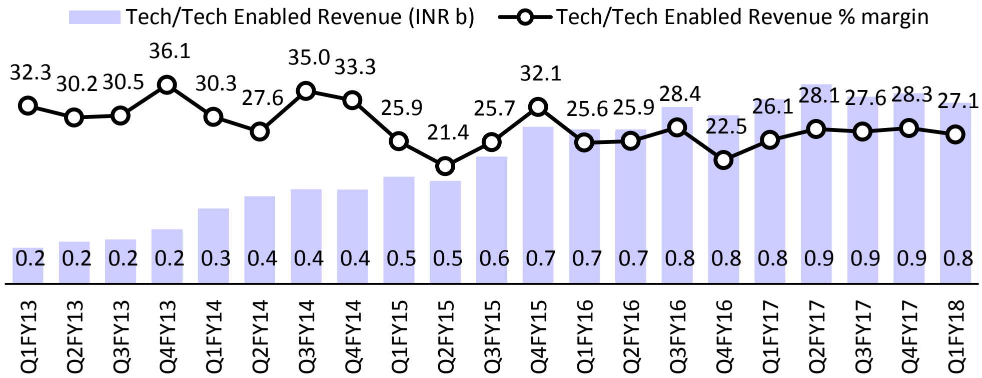
Prime Focus Technologies (PFT) offers cloud-based media ERP solutions for the global media & entertainment (M&E) industry, which manages content and enterprise workflows. It also offers SLA (service-level agreement)-based suite of media processing and monetization services. PFT grew ~10x in the last five years to record revenue of INR3.5b in FY17, and employed ~ 2,200 people. We expect the segment to grow at a steady 15% CAGR over the next three years to reach INR5.3b in FY20. EBITDA margin should improve 90bp to 28.5% during the same period.

Exhibit 31: Tech segment to witness an uptick



Source: MOSL, Company

Exhibit 32: Quarterly trend in revenue and margins



Source: MOSL, Company

Service biz driving technology offtake

PFT provides two key offerings (Services and Products) to the media companies.

- **Service segment:** It streamlines the content based on a broadcaster's requirements. Scope of work includes: i) converting content into digital formats, ii) offering metadata services like tagging and creating data modules, iii) content localization by adding subtitles, dubbing and close captioning, and iv) transformation services like on-air promos (OAP), re-mastering, quality check (QC), editorial and packaging.
- **Technology:** It provides cloud-based media ERP solutions apart from cloud operations and data management products to digital and OTT platforms.

Exhibit 33: PFT offerings

Products	Services
Cloud Media ERP	**Data Services**
❖ Cloud MAM	❖ Meta-data
❖ Broadcast Cloud	❖ Analytics
❖ DX Production Cloud	
❖ Distribution Cloud	**Content Localization**
Operations Cloud	**Content Transformation**
❖ Playout Cloud	❖ Digitization & QC
❖ Playout Monitoring	❖ Content Preparation
	❖ Content Remastering
Digital & OTT platforms	❖ Editorial & Packaging

Source: MOSL, Company

Exhibit 34: Comparison of services provided

Company	Key Geographies	Media Asset Management	Media ERP	Available on cloud	Services		
					Transformation Services	Localization Services	Data Analytics Services
PFT	India, US, UK & South Africa	✓	✓	✓	✓	✓	✓
Deluxe	US & UK	✓	×	✓	✓	✓	✓
Ericsson	US, UK, Germany, France, Spain	✓	×	✓	✓	✓	✓
Dalet	US, UK, Gemany, France	✓	×	✓	×	×	×
Avid	North America, Europe	✓	×	×	×	×	×
Accenture	North America, Europe, Asia	✓	×	✓	×	×	✓
Extreme Reach	North America	✓	×	✓	×	×	×
Encompass	North America, Europe	✓	×	✓	✓	✓	×
SDI Media	North America, Europe	×	×	×	×	✓	×

Source: Industry, MOSL

Strong Indian contracts testify product capabilities

PFT has made deep inroads in the Indian market, partnering with big broadcasters like Star TV, Color TV/Viacom and Sony. Nearly 70% of revenue is generated in India, while rest is generated in the US. The opportunity for ERP solutions in the media industry is huge, given that despite digital content evolution most of the broadcasters in India and globally depend on legacy systems, and there are no direct peer offering complete solutions on the line of PFT.

Fast-growing clientele

PFT works with major content owners like broadcasters, studios and OTT players in India and overseas. Growth in the PFT segment is led by both farming existing clients by increasing content delivery offerings and hunting new clients in the overseas market, given strong product positioning, low absorption and limited direct competition.

Exhibit 35: Strong clientele

Broadcasters	OTT players	Studios
STAR TV	Google	Disney
Star Sports	Amazon	Warner Bros
Discovery Channel	Unilever	Legendary Pictures
National Geographic Channel	Hindustan Unilever Limited	Fox
HBO	Nestle	Eros International
BBC	JWT	
Sony Entertainment	Amazon Prime	
Colors	Turner and Amazon	
Starz Entertainment	Hotstar	
Tru TV	Voot	
SABC	HOOQ	
Global Eagle Entertainment		
Cricket Australia		
FX Network		
Miramax		
Crown Media		

Source: Industry, MOSL

Recent DAX acquisition and high-profile hiring to provide global inroads

Key benefits of DAX acquisition

In March 2014, the company acquired DAX, a cloud-based ERP solution provider offering pre-production film modules to studios.

- **Product offering**: It offers dailies and production workflows, optimizer for AmazonWeb Services, and promo operations for Adobe Premier Pro. DAX offers complementary products in comparison to PFT's in-house clear module, which largely supports post-production processes. DAX provides processes catering from the time of shooting to the implementation of the project.
- **Strong client inroads**: DAX has deep client relations with studios in North America. Thus, the acquisition is expected to offer client penetration via cross-selling services to DAX's clients.

Growth drivers for Tech business

Sticky revenue model, robust order book to drive growth

PFT has high annuity revenue contribution of 71%, along with 34% contribution from international revenue. The business has significant stickiness with ~71% annuity mix. PFT has tasted good success in the Indian market, with Star being its anchor client (accounting for 40-50% of revenues). PFT has a robust order book of over USD200m to be executed over the next 2-3 years, with strong contribution from the annuity business. It is now replicating its domestic success globally, and has built a robust order book of USD200m and sustained EBITDA margin of 25-30%.

PFT's growth going forward will be led by the inroads made in US broadcasters, film and ad market, whereas the Indian segment should witness 10-15% growth. We believe the gestation period for overseas growth is near to its end, with multiple management initiatives like:

a. Completion of product and client integration of the recently acquired DAX in the last 6-9 months
b. High-profile sales resource investment
c. Inroads with large clients like Turner (Latin America) and Warner Bros

This should allow it to get faster client access and thus drive sales.

Well funded for growth

PFT raised USD10m from Ambit Pragma PE at an enterprise valuation of USD200m in August 2016. The capital will be used for gaining deeper penetration and growth in strategic markets such as North America & EMEA with increased sales and marketing efforts.

Huge white space in global markets; Piecemeal peer offerings weakens competitive landscape

To meet increasing demand for digital content with low cost of ownership, content creators and distributors need to automate functions and workflows. Merely converting content into digital form may not be enough. With 800m iTunes users, 75m subscribers on Netflix, 6b hours of video watched/month on YouTube, and 19% of US millennial using Amazon Prime, there is a need for content enterprises to become hyper-digital, bringing together departments, providers and distributors under one system to access, alter and operate the same content.

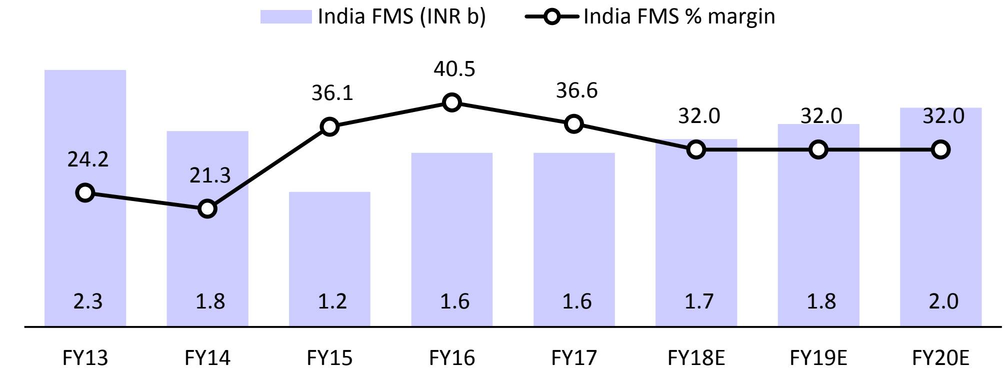
By virtualizing content supply chain operations and implementing business process management modules across the enterprise, the ERP solution can free up human bandwidth (maximizing operational efficiencies), bring in savings in operating costs, and enable monetization and addition of new revenue streams.

Indian film business – a cash cow

Dominant player in the moderate growth market

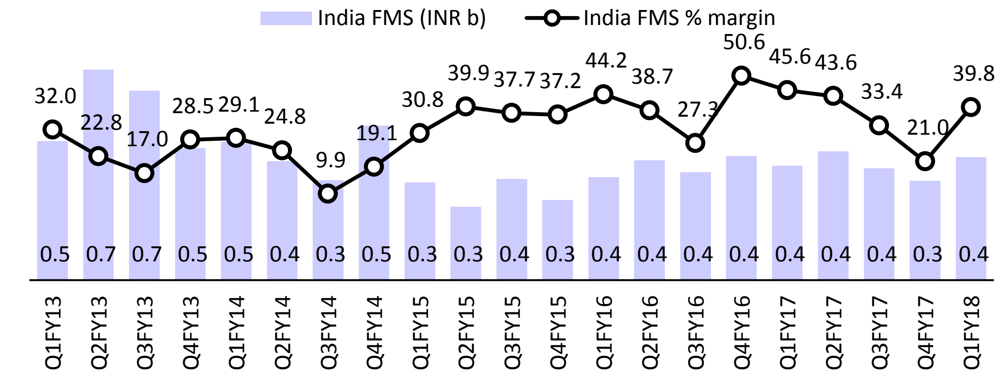
- **Post the acquisition of RMW in July 2014, PFL has established itself as a dominant player in the India film market, offering both pre- and post-production equipment/services.**
- **We expect the segment to witness moderate revenue/EBITDA CAGR of 8%/3% over FY17-20E as majority of the market turns captive.**

Exhibit 36: Margins to range between ~31-33%



Source: MOSL, Company

Exhibit 37: Quarterly trend in revenue and margins



Source: MOSL, Company

Offering complete bouquet of media services

India FMS segment offers complete media services across the spectrum, including production (equipment rental and line production), post-production (digital intermediate/color grading and pictures) and creative (visual effects, 3D conversion and animation) services.

Stable growth, healthy margin

India FMS segment dominates the Indian M&E market, with revenue of INR1.7b as of FY17 (8% of the company's overall revenues). It has garnered high EBITDA margin in the range of 30-40% over the past few years. Indian FMS is its oldest business, operating with Bollywood projects. The segment operates on a rental business, offering post-production studio services for movies, TV and ad projects. This business is expected to grow revenues at 10% and sustain its current EBITDA margin of ~35%.

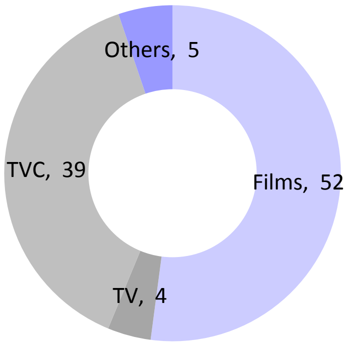
Dominant player in India

PFL is one of the largest camera equipment rental companies in India with its huge inventory of over 40 high-end film cameras. PFL owns a dedicated 10,000 sq.ft. integrated studio, accounting for ~25% of capacity of the Mumbai studio market. The company is pioneer of digital intermediate technology in the Indian film industry, and has provided color grading services for almost 500 films.

Steady annuity business

In India FMS business, revenue per project is increasing on the back of its comprehensive offering, including production, post production and creative services. Films contribute ~50% of the market and should drive overall growth as production budgets continue to rise and VFX/post-production services substitute live production.

Exhibit 38: India post-production by category, 2015 (%)



Source: Industry, MOSL

Improved balance sheet, healthy cash flow potential

RoIC to reach 19% by FY20E led by steady OCF and moderate capex

- **PFL witnessed ~ 2.8x increase in net debt to INR 13.9b and 50% equity dilution over the last five years on the back of the FCCB repayment woes and four M&A transactions. However, improving operating cash flows should ensure steady deleveraging.**
- **Post the provisioning of INR2b debtors in FY16, debtor days have reduced from 108 in FY15 to ~40 in FY17.**
- **Savings on capex and lower working capital should help FCF reach new highs from its lows. We expect FCF generation of INR4.6b by FY20 and return ratios to resurge, with RoIC growing to 19% by FY20**.

Debtor days reduced – legacy working capital issues addressed

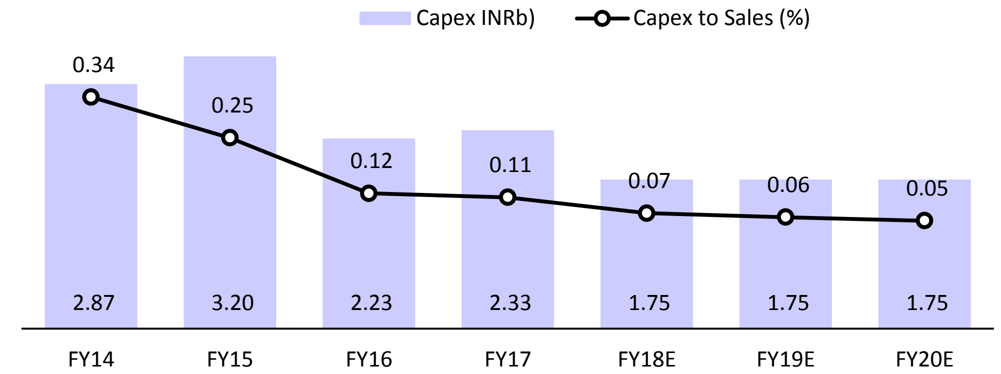
Debtor days, which were over 130 in FY13-14, have reduced to ~40. The legacy issues have been addressed, with PFL provisioning INR2b debtors in FY16 and thus cleaning the balance sheet. Working capital days over the last two fiscal years have been in the 60-90 range.

In 2012-13, in order to take advantage of the new 3D vogue in the market, PFW tied up for 3D conversion of Bollywood movies on a revenues sharing model, which did not take off in the global markets as 3D ecosystem for home viewing failed to pick up. Lucasfilm (acquired by Disney in 2012) and Warner too shelved plans after offering three and one movie contracts, respectively. With huge bench strength and investment, debtors to the tune of INR2b were not recovered toward the revenue sharing of Bollywood 3D movies, bloating the balance sheet and raising corporate governance concerns. However, with INR2b debtor provisioning, the balance sheet has turned much leaner.

Capex to sales likely to taper off

As the company concluded the inorganic investments, the focus should shift toward leveraging the full potential of the transactions by bringing operational synergies. Subsequently, we expect the company to not involve in heavy capex over the next 2-3 years. Capex reduced from an average of INR3b over FY14-16 to INR1.5b in FY17. We have factored in INR1.75b annual capex over FY18-20E. Capex to sales has reduced from 34% in FY14 to 7% in FY17, which should further reduce to 5-6% over FY18-20E.

Exhibit 39: Capex to sales to continue reducing



Source: MOSL, Company

Acquisition spree

PFL has grown 10x over the last 10 years (since IPO), both organically and inorganically. The company's inorganic growth was largely in the developed nation to seek inroads in the premium VFX/3D market, which remains concentrated with high competitive barriers, but offers huge potential to grow. Characterized by deep client relationships, past experience and quality, the US/UK post-production market has seen limited entry of new players. PFL's acquisition in that context was justifiable to make inroads in the high profitable developed market. The acquisitions of Double Negative and Gener8 were the biggest growth drivers, providing entry into the top Hollywood Studio's VFX/3D projects with investment support from RMW.

We believe, going forward, growth should be largely driven organically, given its strong foothold in the premium VFX market in the US.

Healthy CFO can manage debt repayment obligation

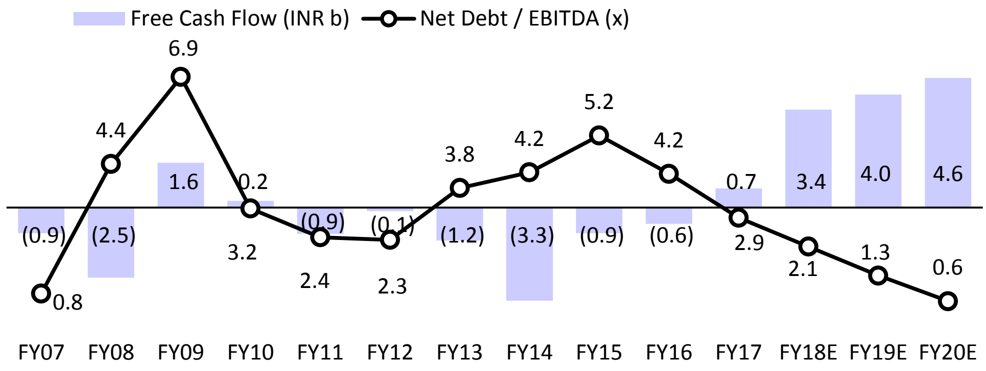
Over the past few quarters, the company has utilized proceeds from the sale of non-core assets to reduce debt.

- Sold LA building worth USD20m (~INR 1.3b); sales proceed were primarily used toward debt reduction.
- Divested illiquid stake in Digital Domain subsidiary in exchange for net stake worth of USD30m (marketable securities) in Digital Domain; proceeds used mainly to retire debt.
- Second part of the transaction for USD20m in marketable securities is still in process.
- Debtor days reduced.

PFL has net debt of INR 13.9b and net debt to equity of 2.5x, with net debt to EBITDA of 2.1x on FY18E. The company has INR1.9b repayment in November 2017 and additional INR1.9b in November 2018.

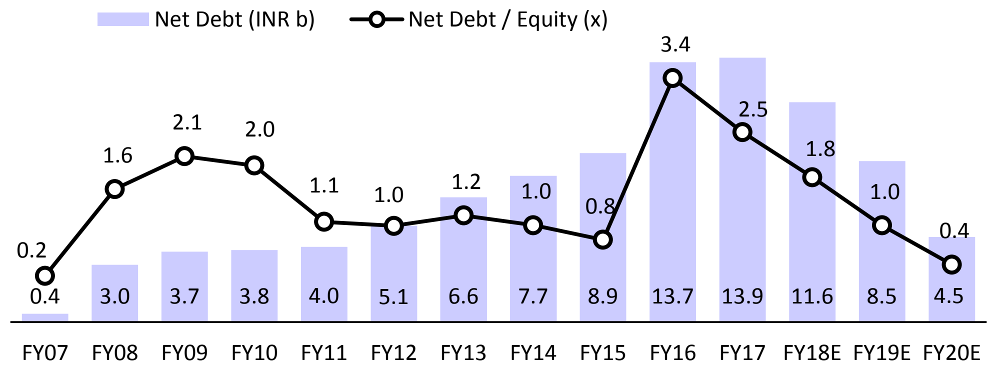
We believe, over the next 2-3 years, steady operating cash flow should allow it to deleverage the balance sheet. We expect OCF generation of INR5.2b/5.7b in FY18/19E. Post interest and capex, estimated FCF for FY18/19 stands at INR3.4b/4.0b. This should partly allow it to fulfill FY18 and FY19 debt repayment of INR1.9b each.

Exhibit 40: FCF to touch new highs



Source: MOSL, Company

Exhibit 41: Deleveraging in sight

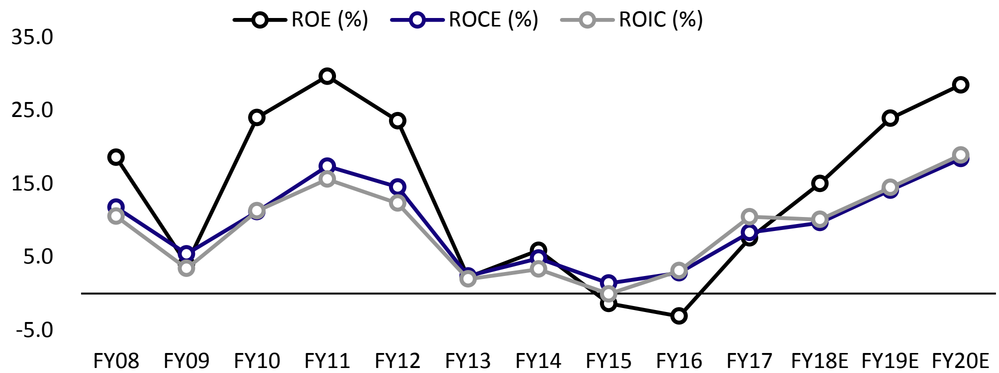


Source: MOSL, Company

Margin accretion, improved asset turns should support FCF generation and return profile

Recovery of profitability and improved asset turns should drive healthy FCF generation and return profile over the next three years. PFL's EBITDA is expected to grow ~1.6x from INR4.8b in FY17 to INR7.8b in FY20, growing at 18% CAGR. Asset turns have improved over the last three years from 0.6x in FY15 to 1.1x in FY17. We expect asset turns to be maintained at current level, as PFL plans to drive synergy gains for inorganic growth over the last 3-4 years. Subsequently, improving margin and stable asset turns are likely to drive RoIC from 11% in FY17 to 19% in FY20E. RoE should also improve from 8% to 29% over the same period.

Exhibit 42: Resurgence in returns



Source: MOSL, Company

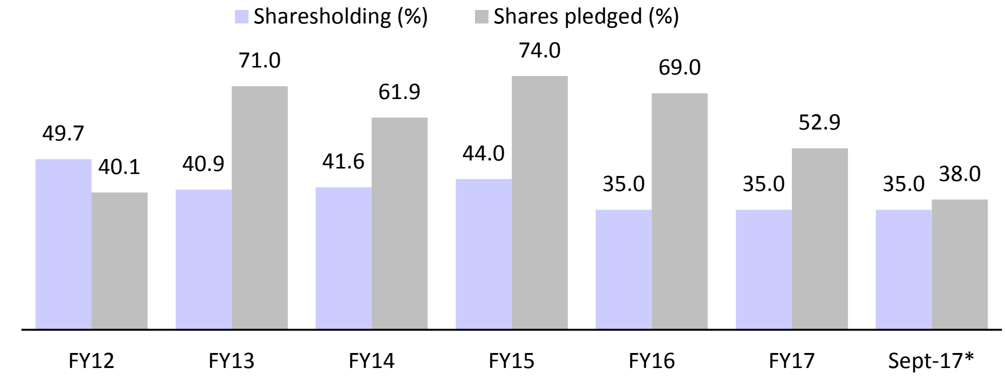
6% dilution led by ESOPs offer

The company had approved an ESOP plan in August 2014, where up to 6% of the paid-up capital of the company (post the preferential allotment in 2015), aggregating to 17.9m stock options, is to be paid to all eligible employees of the company, subsidiaries and associates. While the company has not disclosed details of this ESOP plan, we believe that a bulk of the ESOPs has been already granted, and with a vesting period of 3-5 years should start hitting the share count in FY20E.

Promoter's pledge reduced

Prime Focus being a service-oriented company has limited fixed assets for hypothecation of loans. This had forced the promoters to pledge shares as hypothecation for business loans. Promoter shares pledged pertain to the term loan, working capital loans, cash credits/overdraft from banks. In FY13, the pledge increased further to cover MTM as the stock remained volatile on the back M&A activity, which worsened the leverage position. However, with the operational momentum regained and share price back to INR100 level, the promoter pledge has reduced from the peak of 74% in FY15 to 38% in Sept-17, and could come down further.

Exhibit 43: Promoter shareholding and shares pledged



*As on 21/09/17 Source: MOSL, Company

Corporate restructuring

Over the last 10 years, since IPO, the company has been involved in five acquisitions/M&As – DAX, Gener8, Double Negative, RMW, Frantic Films and Post Logics Studios. Each of these has been pivotal in helping it make inroads in the global market. Given its limited size, it has used external sources of funding. We have outlaid each transaction below, along with its purpose.

Merger & acquisitions

- **Gener8**

  It was acquired in March 2015 for an enterprise value of CAD16.5m, of which CAD6.5m was upfront payment and additional CAD2m was annual payment for five years. The amount was settled for total 7m in April 2017. The purpose of the acquisition was to consolidate its position in the 3D Hollywood market. The two companies together enjoy market share of ~50% in the Hollywood stereo conversion market.

- **Reliance Media Work (RMW)**

  In July 2014, RMW merged with PFL. RMW was issued equity in PFL of INR3.5b with fresh equity of 67.3m at INR52/share (enterprise value of INR5.5b). Additionally, INR2b debt is not yet absorbed – the timing for this depends on the transfer of Film City lease, which is currently in RMW's books. This could be absorbed in a couple years, when the lease gets transferred. The merger with RMW provided PFL with:
  - Studios with 200,000 sq. ft. located in Film City, Mumbai
  - 90,000 sq. ft. SEZ in Navi Mumbai and 75,000 sq. ft. facility in Film City, Mumbai
  - Lowry Digital's Image processing unit
  - 30% stake in Digital Domain

  The merger also facilitated additional INR1.2b equity investment by RMW, which was utilized for upfront payment for DNeg merger. The merger trigged a mandatory open offer, which took its total shareholding to 45%, of which 9.75% was later acquired by Standard Chartered Private Equity, reducing RMW's stake to 35.1%. The merger also allowed PFL to turn into a full-service FMS provider in India, including creative, technology, production and post-production services.

Exhibit 44: Shareholding snapshot of pre- and post-RMW merger transaction

Stage	Particulars	Total	Promoter	SCPE	RMW
I	**Pre RMW transaction**				
	Shares (m)	185.4	77.1	36.5	-
	% of total shares		41.6%	19.7%	0.0%
II	**New shares issued (m) @ INR52/share**				
	Reliance Capital (worth INR1200m)	23.1	-	-	23.1
	RMW (worth INR3500m)	67.3	-	-	67.3
	Promoter (worth INR1200m)	23.1	23.1	-	-
		113.5	**23.1**	**0.0**	**90.4**
III	**Post RMW transaction**				
	Shares (m)	298.9	100.2	36.5	90.4
	% of total shares		33.5%	12.2%	30.2%
IV	**Open offer**				
	Shares acquired (m)	48.1	4.4	0.0	43.7
	% of total shares	16.1%	1.5%	0.0%	14.6%
V	**Post open offer**				
	Shares (m)		104.6	36.5	134.1
	% of total shares		35.0%	12.2%	44.9%
VI	**Stake sale**				
	RMW's part stake sale to SCPE (shares in m)	29.1	-	29.1	-29.1
	% of total shares	9.8%		9.8%	-9.8%
VII	**Post stake sale**				
	Shares (m)		**104.6**	**65.7**	**104.9**
	% of total shares		35.0%	22.0%	35.1%

Source: MOSL, Company

Double Negative

PFL's subsidiary PFW merged with Double Negative (DNeg) in June 2014, ascribing the latter with an enterprise value of GBP55m, of which GBP12m was debt and GBP24m was upfront cash. Of the rest, GBP7m was 7% equity stake in PFW and GBP12m was deferred payment, of which GBP4m is currently outstanding.

DNeg is one of the top four independent providers of visual effects for films, operating from London and Singapore. It has worked on a series of top-grossing Hollywood VFX movies. The merger provides PFW with strong inroads in the premium Hollywood VFX market. Additionally, it can leverage its low-cost, set-up to improve synergies and garner better EBITDA margin.

DAX

PFL's subsidiary PFT acquired DAX in April 2014 for an EV of USD 12.5m, of which USD 2.5m was debt and 1m cash, while the rest was deferred payment. Currently, USD3m is payable. DAX's Digital Dailies product is a key provider of production workflow and media asset management applications and services to large media companies. The company's complementary product profile and deep client inroads supported PFT's strategy to penetrate the US market.

Frantic Films and Post Logic Studios

This company was acquired in April 2008 for an EV of USD43m, paid in cash, to make inroads in Hollywood's VFX market. The acquisition was funded by raising FCCBs (details mentioned below).

VTR Plc

It was acquired in May 2006 for an EV of GBP6m to make inroads in the UK TV market. It was funded through an IPO issue of INR1b.

Fund raising

- **Ambit Pragma**

  In August 2016, PFT raised USD10m from Ambit Pragma to intensify the development of SaaS products, including CLEAR Media ERP (technology used to tap the digital consumer landscape by enhancing efficiencies), thereby providing impetus to gain deeper penetration in the strategic markets.

- **RMW and Promoters**

  In July 2014, PFL raised INR 1.2b each from RMW and Promoter Group, issuing 23.1m shares at INR52. The cash was utilized to pay INR2.4b upfront toward the merger of DNeg.

- **Macquarie**

  In June 2013, PFL's subsidiary PFW issued USD38m convertible redeemable preference shares (tenure of ~4 years) to Macquarie at 13% IRR by FY17. These shares were compulsorily convertible on a potential IPO of PFW. In 2017, PFW redeemed preference share by paying USD45m in cash (5% IRR) and issued stock worth USD22mn in PFW (4% stake). The funds were utilized largely towards repayment of debt and to grow PFW's VFX business.

- **AID**

  In March 2013, PFW issued preference shares worth INR10m to AID at an EV of USD250m, diluting 3% stake in PFW. The funds were utilized toward growth of PFW's VFX business.

- **Standard Chartered Private Equity (SCPE):**

  Raised INR3.9b (INR1.9b equity and INR 1.9b debt) to repay the FCCB due in December 2012.

  a. In November 2012, PFL raised USD35m (INR1.9b) through fresh issue of 36.5m shares (at INR51.75/share), taking 19.7% stake in PFL.
  b. Borrowed USD35m (INR 1.9b) non-convertible debentures (NCDs) at YTM of 13.5%. This would be partly redeemable in November 2017 with interest - INR1.9b and additional INR1.9b will be paid in November 2018.

- **QIP**

  In November 10, the company raised INR730m by issuing 10.6m shares (at INR68.58/share). The amount was raised to fund growth of the business.

- **FCCB**

  a. Raised USD55m (INR2.2b) in December 2007, with a redemption period of five years and amount of USD79m. The optional conversion price was INR138.68, while CMP at the time of raising the FCCB was INR112. The FCCB was raised to acquire Frantic Films & Post Logic (VFX and 3D player) to enter the attractive Hollywood VFX market.
  b. At the time of redemption in December 2012, the stock price reduced to INR47, which compelled investors to seek debt redemption of USD79m (INR4.2b). PFL subsequently raised INR 3.9b from SCPE to settle the FCCB payment on the original due date at the original terms.

- **IPO**

  PFL had an IPO in Jun 2006, raising INR1b by issuing 24m shares (at INR41.7/share). The funds were used to acquire VTR Plc. to enter the post production space in the UK's TV industry.

SWOT analysis

Bull & Bear case

Bull case

- In the bull case, we are assuming a boost in demand from the global VFX industry which has historically grown at 10% CAGR over the last five years, to continue its pace. Furthermore, we note that 19 of the top-25 Hollywood films in 2016 were released in the 3D format indicating the growing demand for 3D content resulting in a further more robust order book for creative segment. Over FY17-20, we assume revenue CAGR of 17% (15% in base case) and with economies of scale, we expect the EBITDA CAGR of 24% (22% in base case).
- We assume that PFL with a range of service and technology products under the Tech/Tech enabled umbrella is well poised to reap benefits of the latent demand from the broadcasters in India and globally (dependent on legacy systems). We expect the Tech segment order book to get a fillip resulting in revenue CAGR of 16% over FY17-20 (15% in base case) and EBITDA CAGR of 18% over FY17-20 (16% in base case).
- Accordingly, we are assuming 270bp EBITDA margin expansion (150bp in base case) to 25.0% over FY17-20. This will lead to EBITDA CAGR of 21% over FY17-20.
- Assuming a target multiple of 11x in the bull case for creative segment (instead of 10x base case), we get a bull case target price of INR148 (upside of 62% to CMP) instead of the base case target price of INR130 (upside of 46%), based on FY19E EBITDA.

Bear case

- In the bear case, we are assuming lower growth in global VFX and 3D conversion industry leading to a stable order book. Further, increasing competition in the Hollywood and Bollywood industry impacts pricing, and in turn, margins. Any decline in consumer preference for 3D could impact the company's revenue growth. Over FY17-20, we assume revenue CAGR of 13% (16% in base case), EBITDA CAGR of 11% (22% in base case).
- We assume that the company will face pressure from new entrants in the tech business which would restrict the company to sustain large orders. We assume revenue CAGR of 12% over FY17-20 (15% in base case) and EBITDA CAGR of 8% (16% in base case).
- Accordingly, we are assuming 220bp EBITDA margin dip (150bp expansion in base case) to 20.1% over FY17-20. This will lead to EBITDA CAGR of 7% over FY17-20.
- Assuming a target multiple of 9x for creative and tech (instead of 10x base case), we get a bear case target price of INR92 (+0%), instead of the base case target price of INR130 (upside of 46%), based on FY19E EBIDTA.

Scenario Analysis – Bull Case

	FY17	FY18E	FY19E
Sales (INR m)	21,536	25,001	29,038
Sales growth (%)	13.3	16.1	16.1
EBITDA (INR m)	4,770	5,748	7,026
EBITDA Margin (%)	22.1	23.0	24.2
EBITDA growth (%)	45%	20%	22%
PAT (INR m)	1,275	1,077	2,263
PAT Margin (%)	1.7	4.3	7.8
PAT growth (%)	-255.8	195.0	110.1
EPS (INR)	1.2	3.6	7.6
Target EV/EBITDA multiple (x)			10
Target price (INR)			**148**
Upside/downside (%)			62

Source: Company, MOSL

Scenario Analysis – Bear Case

	FY17	FY18E	FY19E
Sales (INR m)	21,536	24,067	27,074
Sales growth (%)	13.3	11.7	12.5
EBITDA (INR m)	4,770	4,843	5,439
EBITDA Margin (%)	22.1	20.1	20.1
EBITDA growth (%)	45%	2%	12%
PAT (INR m)	1,275	430	947
PAT Margin (%)	1.7	1.8	3.5
PAT growth (%)	-255.8	17.6	120.4
EPS (INR)	1.2	1.4	3.2
Target EV/EBITDA multiple (x)			9
Target price (INR)			**92**
Upside/downside (%)			+/-0

Source: Company, MOSL

Initiating coverage with a Buy rating

SOTP-based target price of INR130

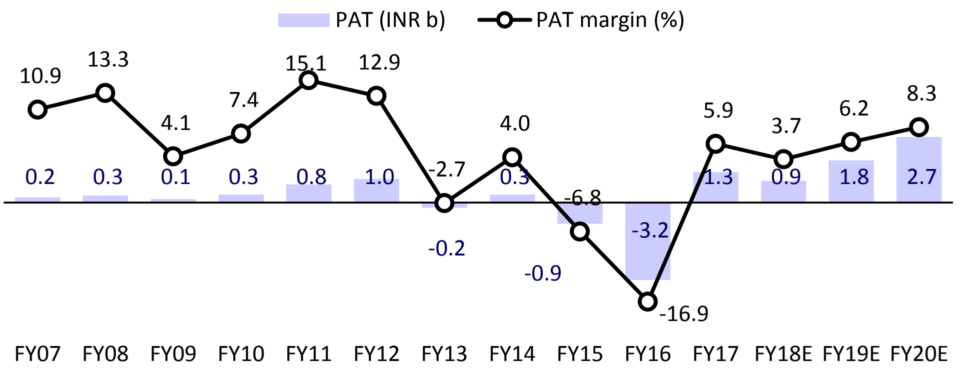
- **We initiate coverage on PFL with a Buy rating and a TP of INR130 (46% upside).**
- **We believe that improving return ratios and FCF generation offer strong re-rating potential.**

Valuations – SOTP-based value of INR130

The stock is trading at adj. P/E of 15.2x and EV/EBITDA of 5.4x on FY19E basis. Based on our SOTP valuation, we arrive at a TP of INR130, with an implied EV/EBITDA of 10x on FY19E EBITDA.

We have valued Creative and Tech/Tech-enabled business at 10x EV/EBITDA. This is on based on a.) Average valuation of media companies in India, as Prime Focus does not have a direct competitor in India, while global peers are small segment in large conglomerates. b.) PFL's last 5-6 year's one year forward EV/EBITDA is ~7.5x. However, we think, recovery of profits in FY17 and Creative and Tech business's steady 20% EBITDA CAGR for over FY17-19E and PFL's 24% ROE in FY19E should create a strong and sustainable economic moat for the company. The India FMS is valued at 6x EV/EBITDA due to its lower scale and moderate growth expectation.

Exhibit 45: Turnaround in bottom line



Source: MOSL, Company

Implied P/E on our estimates works out to be 22.1x/15.1x on FY19/20E. The company's turnaround in earnings should be further supported by margin-led improvement in profitability. Subsequently, improving return ratios and FCF generation should provide strong rerating potential. We initiate coverage with a Buy rating and a TP of INR130 (46% upside).

Exhibit 46: SOTP based on FY19E (INRm)

	EBITDA	EV / EBITDA (x)	Enterprise Value	Net Debt	SH Value	Ownership (%)	Proportionate SH Value	Value/Share (INR) (Gross)	Holding co. discount (%)	Value/Share (INR) (Net)
Creative Services	4,845	10	49,414	3,929	45,485	80	36,388	122	15	104
Tech and Tech Enabled	1,195	10	11,950	4,544	7,406	74	5,481	18	15	16
Indian FMS	535	6	3,208	0	3,208	100	3,208	11	0	11
Total Value	**6,574**	**10**	**64,573**	**8,473**	**56,100**		**45,077**	**151**		**130**

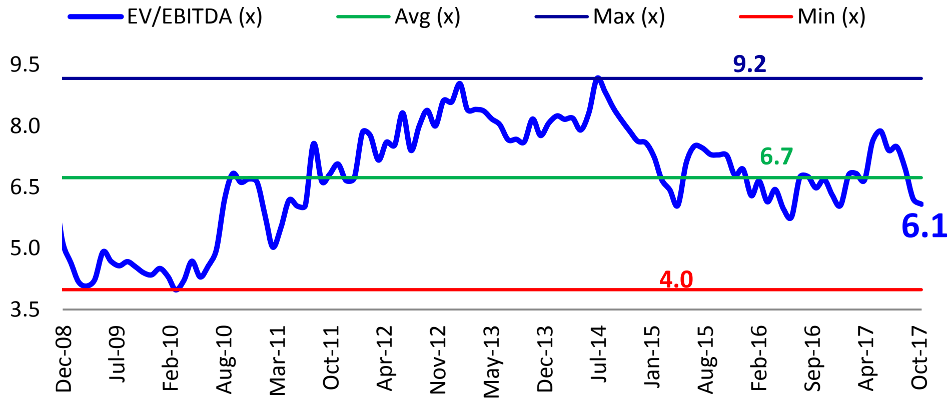
Source: MOSL, Company

Exhibit 47: Implied PE Multiple

	FY18E	FY19E	FY20E
TP (INR)	130	130	130
EPS (INR)	3	6	9
Multiple (x)	42.9	22.1	15.1
CMP (INR)	89	89	89
Upside/ (Downside) (%)	46%	46%	46%

Source: MOSL, Company

Exhibit 48: Prime Focus Ltd- 1yr forward EV/EBITDA (x)



Source: MOSL, Company

Risks

- **Pricing pressure in Hollywood and Bollywood industry**
  Increasing competition in the Hollywood and Bollywood industry impacts pricing, and in turn, margins.
  Mitigation: The risk is mitigated by offshoring parts of the project to cost-effective locations (PFL has a unique world sourcing model, with a global network of 22 offices across all major content markets, employing over 8,000 people).

- **Lumpy nature of 3D projects**
  The company's stereo conversion business is project-driven. Thus, any delay in the project on the part of the filmmaker effects revenue growth of the company and adds to lumpiness on a quarter-on-quarter basis.
  Mitigation: The risk is mitigated by increasing share of VFX contracts in the order book, which are long-term in nature, and of PFT (71% annuity revenue) on account of a continued non-linear growth rate.

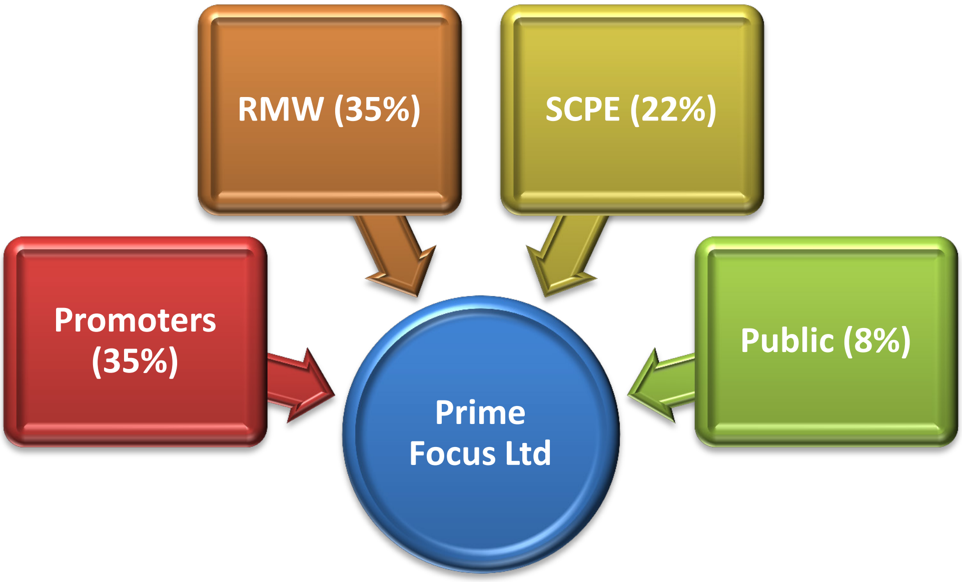
- **Changing consumer preference for 3D content**
  After the success of Avatar, the success of 3D movies did not pick up as expected. Any decline in consumer preference for 3D could impact the company's revenue growth.
  Mitigation: There has been a huge revival in 3D demand over the past few years; 8 of the 10 highest grossing films of 2015 were released in 3D.

- **Volatility in foreign exchange**
  Sharp currency movements could impact the company's profitability, given that a major chunk of revenue is generated in the UK and North America, while a majority of the costs are in Indian Rupee.
  Mitigation: The Company has an experienced foreign exchange management team undertaking continuous monitoring of currency markets.

Annexure

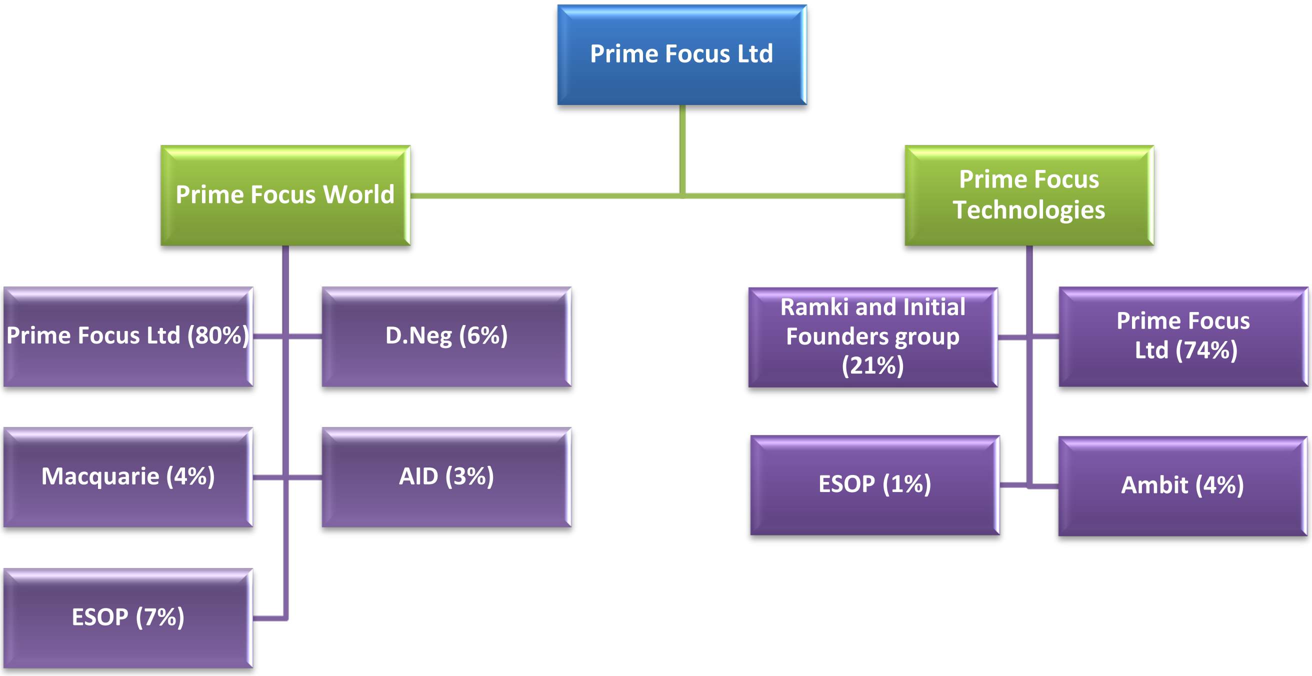
PFL shareholding, corporate structure and corporate transactions

Exhibit 49: Prime Focus shareholding



Source: MOSL, Company

Exhibit 50: Prime Focus corporate structure



Source: MOSL, Company

Exhibit 51: Corporate Transactions

Year	Transaction type	Company	Value (INR m)	Funding Source/Usage	Reason
Apr-06	Acquisition	VTR Plc	416	IPO	Inroads in the UK TV market
May-06	Equity Funding	IPO	999	IPO of 23.9m equity shares (FV INR10) @ issue price of INR41.7	Expansion of India and worldwide operations
Dec-07	Debt Funding	FCCB	2,163	FCCB worth USD55m	Acquisition of Frantic Films & Post Logic Studios
Apr-08	Acquisition	Frantic Films & Post Logic Studios	1,699	FCCB worth USD55m	Enter the attractive Hollywood VFX market.
Nov-10	Equity Funding	QIP	730	QIP of 10.6m equity shares (FV INR1) @ INR 68.6	Expand operations
Dec-10	Equity Funding	Promoter	518	Issued 1m warrants @ INR555 to Mr Namit Malhotra (converted to equity shares in April-12)	Expand operations
Oct-12	Equity Funding	SCPE Investment	1,891	Issued 36.6m equity shares @ INR51.8	Repayment of FCCB borrowed in Dec-07 worth USD79m (Principal-USD55m + premium on redemption-USD24m)
Mar-13	Equity Funding	AID Partners Capital Limited	544	187,500 class B convertible redeemable preferred shares of PFW (convertible into 4% equity)	Investment of $10m in PFW to implement next phase of growth
Jun-13	Equity Funding	Macquarie Capital	2,091	827,781 of class A convertible redeemable preferred shares of PFW	Investment of $38m in PFW to implement next phase of growth
Apr-14	Acquisition	DAX	760	Internal Accrual / Debt	Acquisition of DAX ($9.1m) with a vision to virtualize the content supply chain before, during and after the production phase.
Jun-14	Merger - Paid	Double Negative	4,984	Promoter and Reliance Capital	Merger of DNeg. (£55m), forming world's largest integrated VFX, stereo conversion and animation services company
Jul-14	Equity Funding	Promoter	1,200	Issued 23.1m equity shares @ INR52	Funding for acquisition of DNeg. & DAX
Jul-14	Equity Funding	Reliance Capital	1,200	Issued 23.1m equity shares @ INR52	Funding for acquisition of DNeg. & DAX
Jul-14	Merger - Paid	Reliance Media works	3,500	Issued 67.3m equity shares @ INR52 for 30.2% stake	Merger with Reliance Media Works to offer "all under one roof" bundled services to clients.
Mar-15	Acquisition	Gener8 Digital Media Corp Limited	506	Internal Accrual / Debt	Secure an exclusive license to use Gener8's proprietary 3D conversion technology G83DTM.
Aug-16	Equity Funding	Ambit Pragma PE	600	Equity funding in PFT	Working capital in overseas markets

Source: MOSL, Company

Management profile

Namit Malhotra
Founder, Executive Chairman and Global CEO
As the founder of Prime Focus, Namit has been responsible for the strategy, growth and success of Prime Focus from its modest beginnings in Mumbai in 1997 to its current position as the world's largest independent and integrated media services powerhouse. He also serves as Chief Executive Officer at Prime Focus World, N.V.

Ramki Sankaranarayanan
Managing Director (Also, Founder and CEO, PFT)
In his role as managing director, Ramki spearheads the group's operational planning that reflect the longer-term objectives and priorities established by the board. Ramki has 18 years of IT industry experience. Prior to starting PFT in 2007, he was CEO of Subex Technologies and before that, Global Head of Sales and Marketing for Product R&D Services at Tata Elxsi. Ramki is an engineering graduate from BITS Pilani and an MBA from SP Jain Institute of Management & Research, India.

Nishant Fadia
Group Chief Operating Officer
Nishant took up this role in August 2014. Before this, for 14 years as its first CFO, Nishant was the face of Prime Focus to the financial community. He took the company public in 2006. Nishant is a Chartered Accountant from ICAI and CPA from the American Institute of Certified Public Accountants (AICPA) in the US.

Vikas Rathee
Group Chief Financial Officer
Vikas has over 17 years in Corporate Finance, TMT (Telecom, Media and Technology) Investment Banking, Capital Markets and M&A across US, Europe and Asia. Before this, Vikas was Head - Corporate Finance and M&A at Suzlon Energy, Principal - TMT Investment Banking at Bank of America Merrill Lynch and Executive Director - TMT Investment Banking at ABN AMRO. Vikas is a CFA, an MBA in Finance from the R.H. Smith School of Business, University of Maryland and an Engineering graduate from Delhi Institute of Technology, Delhi University.

Alex Hope
Managing Director, Double Negative
Alex is a veteran in the VFX industry. Prior to this, he was at MPC, where he served as the board director for 2years and as producer for 5 years. Alex was also the co-author of the 2010 DCMS-commissioned Next Gen Report and is a Board Director of Creative Skillset.

Matthew Holben
Co-Head of VFX, CEO and Co-founder Double Negative
Mathew primarily oversees management and business development for Double Negative. He has been instrumental in the setup of the company's new state-of-the-art London facility and the launch of three important divisions: Double Negative Films, Double Negative TV and Feature Animation.

Financials and Valuations

Consolidated - Income Statement						(INR m)
Y/E March	**FY15**	**FY16**	**FY17**	**FY18E**	**FY19E**	**FY20E**
Total Income from Operations	**12,889**	**19,010**	**21,536**	**24,662**	**28,436**	**32,798**
Change (%)	54.4	47.5	13.3	14.5	15.3	15.3
Employees Cost	8,133	11,560	12,533	14,194	15,755	17,488
Other Expenses	3,053	4,153	4,233	4,975	6,132	7,503
Total Expenditure	**11,186**	**15,713**	**16,766**	**19,169**	**21,887**	**24,991**
% of Sales	86.8	82.7	77.9	77.7	77.0	76.2
EBITDA	**1,703**	**3,297**	**4,770**	**5,493**	**6,550**	**7,806**
Margin (%)	13.2	17.3	22.1	22.3	23.0	23.8
ESOP	0.0	37.0	257.0	250.0	200.0	0.0
Foreign exchange gain/(loss)	80.5	-38.9	-413.9	0.0	0.0	0.0
Depreciation	1,716	2,796	2,546	2,911	3,078	3,244
EBIT	**67**	**425**	**1,553**	**2,332**	**3,272**	**4,563**
Int. and Finance Charges	648	1,074	1,279	1,208	1,038	868
Other Income	277	51	245	116	175	299
PBT bef. EO Exp.	**-304**	**-598**	**519**	**1,240**	**2,409**	**3,993**
EO Items	-971	-2,428	968	0	0	0
PBT after EO Exp.	**-1,275**	**-3,026**	**1,488**	**1,240**	**2,409**	**3,993**
Total Tax	-296	696	90	248	482	998
Tax Rate (%)	23.2	-23.0	6.0	20.0	20.0	25.0
Minority Interest	-106	-501	123	87	169	263
Reported PAT	**-873**	**-3,221**	**1,275**	**905**	**1,758**	**2,732**
Adjusted PAT	**-127**	**-234**	**365**	**905**	**1,758**	**2,732**
Change (%)	-133.3	84.1	LP	147.7	94.3	55.4
Margin (%)	-1.0	-1.2	1.7	3.7	6.2	8.3

Consolidated - Balance Sheet						(INR m)
Y/E March	**FY15**	**FY16**	**FY17**	**FY18E**	**FY19E**	**FY20E**
Equity Share Capital	299	299	299	299	299	299
Eq. Share Warrants & App. Money	0	0	0	0	0	0
Total Reserves	10,819	3,783	5,266	6,170	7,928	10,660
Net Worth	**11,118**	**4,082**	**5,565**	**6,469**	**8,227**	**10,959**
Minority Interest	1,540	700	1,142	1,229	1,398	1,661
Total Loans	10,375	15,710	15,218	13,218	11,218	9,218
Deferred Tax Liabilities	-492	822	687	687	687	687
Capital Employed	**22,542**	**21,314**	**22,610**	**21,602**	**21,529**	**22,524**
Gross Block	24,826	26,462	29,770	31,520	33,270	35,020
Less: Accum. Deprn.	11,478	12,938	15,485	18,396	21,473	24,717
Net Fixed Assets	**13,348**	**13,524**	**14,286**	**13,125**	**11,797**	**10,303**
Goodwill on Consolidation	8,030	9,698	8,188	8,188	8,188	8,188
Capital WIP	445	508	197	197	197	197
Total Investments	**857**	**888**	**40**	**40**	**40**	**40**
Curr. Assets, Loans&Adv.	**10,616**	**8,833**	**10,302**	**11,741**	**14,396**	**17,993**
Inventory	6	6	5	5	5	5
Account Receivables	3,756	1,911	2,694	2,703	3,116	3,415
Cash and Bank Balance	616	1,135	1,259	1,602	2,705	4,690
Loans and Advances	6,238	5,781	6,344	7,433	8,570	9,884
Curr. Liability & Prov.	**10,754**	**12,137**	**10,402**	**11,689**	**13,088**	**14,196**
Account Payables	2,505	2,012	1,297	1,689	1,948	2,246
Other Current Liabilities	8,099	10,056	8,849	9,797	10,907	11,681
Provisions	150	69	257	202	233	269
Net Current Assets	**-138**	**-3,304**	**-100**	**53**	**1,308**	**3,796**
Appl. of Funds	**22,542**	**21,314**	**22,610**	**21,602**	**21,529**	**22,524**

Financials and Valuations

Ratios

Y/E March	FY15	FY16	FY17	FY18E	FY19E	FY20E
Basic (INR)						
EPS	**-0.4**	**-0.8**	**1.7**	**3.0**	**5.9**	**9.1**
Cash EPS	5.3	8.6	10.2	12.8	16.2	20.0
BV/Share	37.2	13.7	18.6	21.6	27.5	36.7
DPS	0.0	0.0	0.0	0.0	0.0	0.0
Payout (%)	0.0	0.0	0.0	0.0	0.0	0.0
Valuation (x)						
P/E	-209.2	-113.6	73.0	29.5	15.2	9.8
Cash P/E	16.8	10.4	9.2	7.0	5.5	4.5
P/BV	2.4	6.5	4.8	4.1	3.2	2.4
EV/Sales	2.8	2.2	1.9	1.6	1.2	1.0
EV/EBITDA	21.4	12.5	8.5	7.0	5.4	4.0
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0
FCF per share	-3.0	-1.9	2.3	11.5	13.3	15.2
Return Ratios (%)						
RoE	-1.4	-3.1	7.6	15.0	23.9	28.5
RoCE	1.4	2.8	8.3	9.7	14.1	18.4
RoIC	-0.1	3.1	10.5	10.1	14.5	18.9
Working Capital Ratios						
Fixed Asset Turnover (x)	0.6	0.8	0.8	0.9	0.9	0.9
Asset Turnover (x)	0.7	1.0	0.9	1.1	1.2	1.2
Inventory (Days)	0	0	0	0	0	0
Debtor (Days)	105	54	39	40	37	36
Creditor (Days)	47	43	28	22	23	23
Leverage Ratio (x)						
Current Ratio	1.0	0.7	1.0	1.0	1.1	1.3
Interest Cover Ratio	0.1	0.4	1.2	1.9	3.2	5.3
Net Debt/Equity	0.8	3.4	2.5	1.8	1.0	0.4

Consolidated - Cash Flow Statement (INR m)

Y/E March	FY15 (15M)	FY16 (9M)	FY17	FY18E	FY19E	FY20E
OP/(Loss) before Tax	-2,806	-3,006	1,487	1,240	2,409	3,993
Depreciation	2,211	2,031	2,546	2,911	3,078	3,244
Interest & Finance Charges	668	2,620	1,279	1,208	1,038	868
Direct Taxes Paid	-287	-154	-80	-248	-482	-998
(Inc)/Dec in WC	702	-1,272	-2,069	190	-152	-504
CF from Operations	**490**	**220**	**3,163**	**5,301**	**5,892**	**6,603**
Others	1,638	76	-251	-116	-175	-299
CF from Operating incl EO	**2,127**	**296**	**2,912**	**5,185**	**5,716**	**6,304**
(Inc)/Dec in FA	-3,025	-870	-2,238	-1,750	-1,750	-1,750
Free Cash Flow	**-898**	**-574**	**674**	**3,435**	**3,966**	**4,554**
(Pur)/Sale of Investments	-34	-1	1,917	0	0	0
Others	-1,137	108	-354	116	175	299
CF from Investments	**-4,197**	**-762**	**-674**	**-1,634**	**-1,575**	**-1,451**
Issue of Shares	2,394	0	0	0	0	0
Inc/(Dec) in Debt	798	1,919	-825	-2,000	-2,000	-2,000
Interest Paid	-650	-685	-1,047	-1,208	-1,038	-868
Dividend Paid	0	0	0	0	0	0
Others	2	12	-15	0	0	0
CF from Fin. Activity	**2,544**	**1,246**	**-1,887**	**-3,208**	**-3,038**	**-2,868**
Inc/Dec of Cash	**475**	**780**	**351**	**343**	**1,103**	**1,985**
Opening Balance	141	355	908	1,259	1,602	2,705
Closing Balance	**616**	**1,134**	**1,259**	**1,602**	**2,705**	**4,690**

REPORT GALLERY

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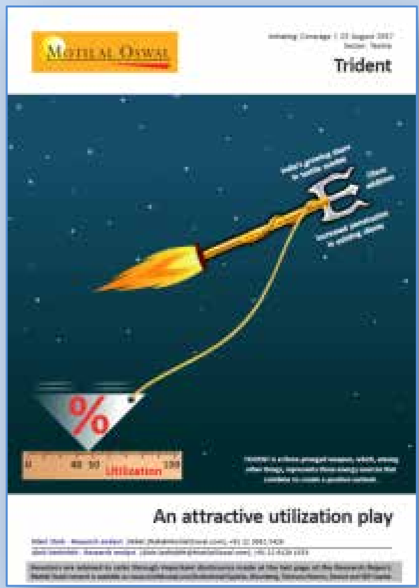

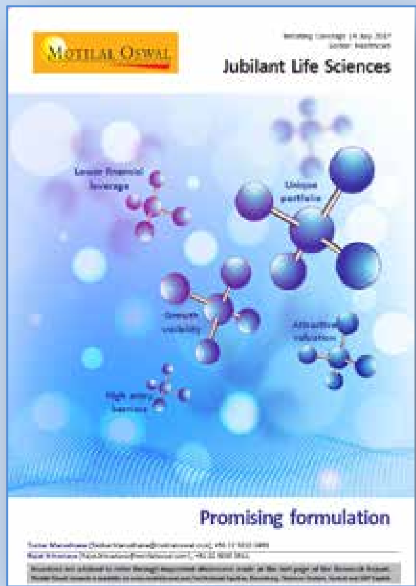

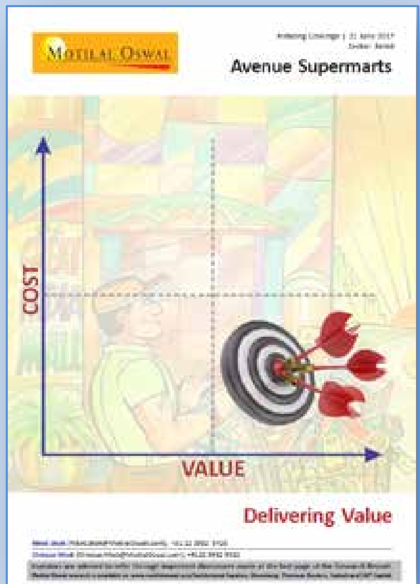

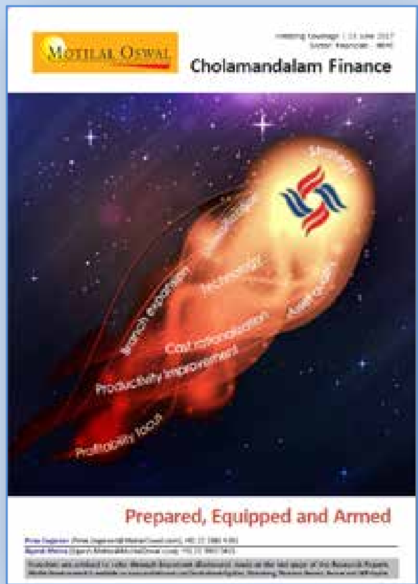

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