RATING REPORT

Cine Star (SMC-Private) Limited

REPORT DATE:
December 31, 2019

RATING ANALYSTS:
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RATING DETAILS		
	Initial Rating	
Rating Category	**Long-term**	**Short-term**
Entity	A-	A-2
Rating Outlook	Stable	
Rating Date	December 31, 2019	

COMPANY INFORMATION	
Incorporated in 2008	**External auditors:** Baker Tilly Mehmood Idrees Qamar Chartered Accountants
	Chairman of the Board: Faraz Ahmad Chaudhry
Key Shareholders (with stake 5% or more):	
Faraz Ahmad Chaudhry – 100%	

APPLICABLE METHODOLOGY(IES)
Applicable Rating Criteria: ***Industrial Corporates (May, 2016)***
http://www. vis.com.pk/kc-meth.aspx

Cine Star (SMC-Private) Limited

OVERVIEW OF THE INSTITUTION

Cine Star (SMC-Private) Limited is incorporated as a single member private limited company with all its shareholding vested by one individual. Total number of employees was reported at 302 at end-June 2019.

Profile of Chairman

Mr. Faraz Ahmad Chaudhry serves as Chairman of Cinestar (SMC-PVT) Ltd. He has completed his Bachelors in Business Administration. He was the former nazim of Gulberg area in Lahore.

Profile of Chief Operating Officer

Mr. Ali Chaudhry serves as Chief Operating Officer of Cinestar (SMC-PVT) Ltd. He is a law graduate and manages all operational matters of this company. Mr. Ali Chaudhry has been associated with the company for the last 8 years.

RATING RATIONALE

Group & Company Profile

Cine Star (SMC-Private) Limited (Cine Star) is a part of the Cine Star Group of Companies which currently has presence in the movie exhibitor (theatre) industry. The company is wholly owned by an individual, Mr. Faraz Chaudhry, who also serves as the Chairman to the Board.

Key Rating Drivers

An exclusive agreement signed between IMAX Corporation, Canada and Cine Star for running IMAX screens across the country is a key competitive advantage.

In March 2014, Cine Star acquired exclusive rights for launching and operating IMAX theatres across Pakistan from IMAX Corporation, Canada (IMAXC). As per this agreement, the company is authorized to open one IMAX screen in each major city including Karachi, Lahore and Islamabad. All installations related to the IMAX screen is done by IMAXC representatives for which Cine Star pays a royalty fee from this screen to IMAXC. To date, Cine Star operates through seven locations and has a total of 11 screens in the city of Lahore, one of which is an IMAX screen. Cine Star has also diversified its presence in Multan and plans to launch screens in Faisalabad and Gujranwala. According to management, Cine Star has a total market share of 70% in Lahore. Cine Star currently has a total capacity of 2,931 seats excluding seats which are to be opened in Faisalabad Gujranwala. The company has a wide array of seat varieties including reclining seats as well as exclusive boxes for 8 to 10 customers.

Table 1: Screens and Seats of Cine Star

Cinema Location	Screen #
Cine Star Township Lahore	Screen 1 Screen 2 (IMAX) Screen 3
Cine Star Xinhua Mall	Screen 1 Screen 2
Ali Trade Centre Gulberg	5 Screens
Cine Star Taj Lahore	Screen 1
Cine Star Multan	Screen 1
Cine Star Gujranwala (coming soon)	Screen 1 Screen 2
Total Seats	**14 Screens**

After healthy revenue[1] growth in FY18, revenue growth slowed down in FY19. Revenue growth is expected to remain constrained in FY20.

With growing demand for cinemas, core income of the company increased significantly from Rs. 580.7m in FY17 to Rs. 1.0b in FY19, depicting an average growth rate of 32.9%. This growth has largely been contributed by new screen additions while there was some impact of increase in ticket pricing for selected cinemas. However, growth in FY19 was significantly lower than preceding year on account of limited new screen additions and decline in seat capacity factor due to ban on Bollywood films in the latter half of FY19. Revenues from ticket sales have averaged 58.7% of net sales over the last 3 years. Largest ticket sales are generated from IMAX screen which represents around one-fourth of overall revenues. While seat capacity factor during weekends continues to remain high, seat capacity factor during weekdays has depicted a noticeable drop. Given that the cinema industry is characterized by its intermediate cyclicality risk and intermediate degree of competitive risk and growth, revenues are also impacted

[1] Revenues are reported net of distributor share

by occurrence of specific events and occasions during a year. Increase in revenues from existing screens is expected to remain constrained over the short-term unless ban on Bollywood movies is lifted. Nonetheless, comfort is drawn from growing viewership demand of Hollywood movies (which remain the key target segment for IMAX screens) which is expected to extend support to revenues in the long term. Moreover, re-defining of audience demographics from lower income classes to higher ones has also historically impacted the overall industry's audience fragmentation and attendance per screen. Overall sales are also complemented by revenues from Cafeteria business and proceeds from Corporate Shows.

Profitability profile supported by healthy margins. With increase in overheads outpacing revenue growth, overall profitability declined during FY19. With limited growth expected in revenues in FY20, sustaining profitability indicators is considered important.
Total gross margin of the company was reported at 47.9% (FY18: 56.9%; FY17: 51.9%) for FY19. Gross margins have remained healthy over the review period but may face pressure in case revenue growth remains constrained. Within different revenue segments, Cafeteria business remains the highest margin business. In absolute terms, aggregate overheads increased to Rs. 163.3m (FY18: Rs. 137.2m). With growth in overheads outpacing sales growth, overheads to sales ratio increased to 15.9% (FY18: 14.5%) in FY19. Given the decline in gross and operating margins, net profitability was lower in FY19 vis-à-vis FY18.

Sizeable debt repayments over the rating horizon are expected to result in modest cushion in debt servicing ability while free cash flows are expected to remain limited given expansion plans. Favorable working capital cycle supports assessment of liquidity profile.
With lower profitability during FY19, fund flow from operations decreased to Rs. 475.3m (FY18: Rs. 601.1m, FY17: Rs. 284.3m). While debt servicing ability improved to 2.07x (FY18: 0.92x; FY17: 0.49x) at end-FY19, cash flow coverage against outstanding obligations remains on the lower side at 0.26x. Given the increase in current maturities from FY21, cushion in debt servicing is expected to remain modest. With current assets being higher than current liabilities, current ratio was reported at 1.88x (FY18: 1.73x; FY17: 1.23x) at end-June 2019. Working capital cycle of the company is considered positive given that majority sale proceeds made to Cine Star are cash-based while payment to its creditors (distributors) is done over a longer time. The distributor is primarily responsible for supplying the cinema with the latest movie releases along with any publicity required for these upcoming movies; no upfront payment is made to the distributor. Payment to the distributor is generally due once the movie is removed from the cinema. Cine Star has also provided a loan (including an interest free advance for ongoing construction of new cinema) to Vision Group of Companies. As per management, the funds given as advance to group companies may be utilized in case of need.

Capital structure is leveraged. Leverage indicators are expected to remain elevated over the rating horizon.
Equity base of the company has grown on a timeline basis on account of profit retention. Equity level was reported at Rs. 1.1b (FY18: Rs. 953.1m, FY17: Rs. 766.0m) at end-June 2019; equity also includes an interest free, subordinated loan amounting to Rs. 140.9m from its director. However, given that setting up a cinema requires sizeable capital expenditure, Cine Star has total debt of Rs. 1.8b. Debt profile largely comprises long term loans, majority of which are expected to be paid off in the coming years. Long term debt from the commercial bank has a payback period of three to five years. Gearing and leverage indicators have historically been reported on the higher side at 1.71x (FY18: 2.22x, FY17: 2.75x) and 2.31x (FY18: 2.78x, FY17: 3.02x), respectively at end-June 2019. Fresh borrowing is expected to be mobilized over the rating horizon for its upcoming projects in Karachi and Islamabad which is expected to keep leverage indicators elevated.

FINANCIAL SUMMARY	*(amounts in PKR millions)*	
BALANCE SHEET	**FY17**	**FY18**
Paid Up Capital	50.0	50.0
Total Equity	766.0	953.1
INCOME STATEMENT		
Revenues	580.7	946.0
Profit before Taxation	175.5	176.2
Profit After Taxation	176.8	187.2
RATIO ANALYSIS		
Fund Flow from Operations	284.3	601.1
Current Ratio (x)	1.23	1.73
Gearing (x)	2.75	2.22

ISSUE/ISSUER RATING SCALE & DEFINITION Appendix II

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA

Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-

High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-

Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-

Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-

Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-

Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC

Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC

A high default risk

C

A very high default risk

D

Defaulted obligations

Short-Term

A-1+

Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1

High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2

Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3

Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B

Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C

Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Cine Star (SMC-Private) Limited
Sector	Media/Entertainment Industry
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
31-Dec-19	A-	A-2	Stable	Initial