

Copyright Reserved

No. of pages: 12



COMMON PRE-SEEN
(KC1 TO KC4)

DECEMBER 2018

Theatre World (Pvt) Ltd

Background

Theatre World (Pvt) Ltd (TWPL) was incorporated in 2007 under the Companies Act No. 07 of 2007. The company is mainly involved in the production, importation and distribution of movies in Sinhala, Tamil and Hindi languages. It is currently the second largest company in the Sri Lankan film industry.

TWPL operates 20 cinema halls out of which 5 are owned by the company. It operates mainly in the Western, Central and Southern provinces, and does not operate in the Northern, Eastern and North Central provinces. TWPL has 3D technology in one of its self-owned theatres and plans to expand this new technology to other selected theatres. The cinema halls/theatres are owned or exclusively franchised by TWPL. Nearly 40% of the content is locally produced. Currently TWPL accounts for approximately 25% of the market share.

The National Film Corporation (NFC) governs the film industry in Sri Lanka and TWPL has obtained the required approvals from it. The company has also obtained licenses from the Excise Department and Municipal Councils. New investments in the latest technology are currently planned and TWPL hopes to bring the latest innovation to the theatres not only through technology but also from the design of new and refurbished sites.

Key strategic goals of TWPL

- Deliver the best cinema experience for cinemagoers
- Give customers a range of offerings, all underpinned by the best customer service
- Be the technological leader in the industry by offering the latest audio and visual technology
- Expand and enhance the theatre footprint across the country
- Enhance shareholder value

Shareholders of TWPL as at 31 March 2018

Name of shareholder	Percentage of shares held
Nihal Fernando	35%
Charith Perera	25%
Providence Holdings (Pvt) Ltd	40%
Total	100%

TWPL is currently owned by Providence Holdings (Pvt) Ltd (PHPL), Nihal Fernando and his best friend Charith Perera. Nihal and Charith met at the University of Kelaniya where they studied Arts and Theatre. Prior to founding the company Nihal worked for a leading film and theatre company in Sri Lanka for 10 years. Charith worked as an intern and executive for 15 years at the Universal Studios in California, USA.

PHPL, which has a 40% shareholding in TWPL, is owned by three shareholders. Charith Perera who is a director of PHPL owns 60% of PHPL. The balance shares are equally held by Saman Nanayakkara (an engineer) and Krishan Pathirage (an architect). PHPL is currently facing working capital issues and TWPL has given loans to PHPL at below market rates. Saman Nanayakkara and Krishan Pathirage of PHPL have shown an interest in divesting fully or partially their current stake in the company.

Directors of TWPL

Name of director	Designation
Nihal Fernando	Chairman and Managing director
Charith Perera	Chief executive officer
Nuwan Perera	Marketing director
Lakshmi Fernando	Operations director
Annesly Silva	Non-executive director

Nihal's daughter is the operations director and Charith's son is the marketing director.

Qualifications and experience of the senior management team of TWPL is given in Annexure 1 while the organisational structure of TWPL is given in Annexure 2.

Employee profile

TWPL has currently employed over 90 employees out of which approximately 50 are at the executive level and the rest are non-executive grade employees. Ninety percent of its staff is male. The film industry generally finds it challenging to retain staff due to late working hours and a lack of career development prospects. In view of this the company hopes to implement employee engagement initiatives across the company. The managing director has stressed the importance of training and development and programmes to improve staff motivation, as the labour turnover has increased drastically in the last year. The lack of a documented human resources policy has been discussed at many board meetings.

Governance, risk and control issues

The chairman of TWPL has planned to bring in a few new investors to the company. This was mainly due to the funding required for the investment in technology, and also to further expand the footprint in the Western province and have a presence in other provinces. A few local investors have shown interest, and the company may issue new shares. Prior to bringing in the new investors the CEO stated that the governance and control deficiencies need to be addressed immediately as highlighted by the external consultant who was hired for a period of one month. The CEO is entitled to incentives based on his performance.

A listing on the Colombo Stock Exchange is also being considered. The consultant noted that the following areas require improvement.

- Lack of a documented strategic plan and IT governance framework.
- The company does not have an audit, risk or remuneration committee.
- A risk assessment has not been carried out.
- The board only has one non-executive director who is an architect.
- Lack of standard operating procedures.
- Lack of health and safety assessments.
- The internal audit function is not properly carried out. Lack of an audit charter and competent staff.
- Internal audit reports highlight related party transactions.
- Many deficiencies are noted in the accounting package, and controls over cash operations and procurement seem to be weak.
- Financial statements have not been audited for the past three years.
- Tax penalties and fines due to late payments.
- Creditors' ageing report highlights long-outstanding balances.

Revenue

For the financial year 2017/18 TWPL recorded a revenue of approximately Rs. 528 million. A reduction in revenue of 20% was noted compared to the previous financial year. This was mainly due to a lack of patrons resulting from not selecting the best films for screening. Revenue also includes web sales, which account for 30% of the total revenue. Increased competition in the form of expansion and upgrades from the market leader also had an effect on the revenue. However, TWPL recorded a profit of Rs. 2 million for the financial year 2017/18. Ticket collections from owned theatres comprised approximately 35% of the revenue while non-owned theatres contributed towards approximately 45% of the revenue. Income from film production and film distribution commissions made up the rest. Other income mainly comprised of retail sales of food and beverages and sponsorship and advertising.

TWPL hopes to screen English movies and thereby increase the number of patrons especially in the Western and Central provinces. The expansion of theatres is planned for the next 5 years in the Northern and Eastern provinces of Sri Lanka. The company hopes to invest nearly Rs. 80 – 125 million a year by opening two theatres every year for the next 5 years. These could be hired or exclusively franchised. TWPL hopes to increase its turnover to Rs. 1 billion based on the 5-year strategic plan. The company is targeting a patron base of 10 million customers by the end of 2025.

Operational statistics for 2017/18 are given below.

Ticket price range	Rs. 200 to Rs. 600
90% of the tickets in a theatre are priced between:	Rs. 200 to Rs. 400
Balance 10% of the tickets (special seats/boxes etc.) are priced between:	Rs. 400 to Rs. 600

Cinema hall size	Seating capacity	No. of cinema halls	No. of times a film is shown per day	Multiplex
Large cinema halls (premium customers)	600	4	4	3 screens
Medium cinema halls	200	12	3	No
Small cinema halls	100	4	2	No
Total		20		

Seasonal fluctuations

Months	Percentage of annual sales
April, August and December	65%
Other months	35%

Language of films	Percentage of sales	Occupancy rates
Sinhala	40%	50%
Tamil	20%	30%
Hindi	40%	40%
Average		40%

TWPL currently has approximately 2.6 million customers.

Cost of sales

The cost of sales of the company mainly consists of film hiring costs (60%). The balance consists of film import costs, film production costs and entertainment tax payments.

Expenses

Major variances were not noted in the administrative and selling and distribution expenses over the last 3 years. There have been a few complaints made by suppliers regarding delayed payment of bills. The Inland Revenue Department has also levied fines against the company in the past 3 years.

Capital expenditure and future expansion

In the past few years TWPL has invested in capital expenditure (CAPEX) to upgrade the current cinema halls. These refurbishments were done to enhance customer experience and improve the layout and seating arrangements. The sound systems were also upgraded and 3D viewing technology is currently being rolled out. The company plans to expand its footprint by opening new theatres or by expanding the franchise network. During 2018/19 TWPL invested approximately Rs. 115 million to construct two theatres in the Northern Province. The company hopes to bring on board new local or foreign partners to meet its ambitious growth targets. It must also be noted that the land and buildings have not been revalued for the past 3 years.

Type of property, plant and equipment	Net book value as at 31 March 2018 (Rs. '000)
Land	478,850
Buildings	197,565
Leasehold buildings	45,765
Furniture and fittings	43,759
Office equipment	2,578
Machinery	5,746
Theatre equipment	175,748
Motor vehicles	35,401
Capital work-in-progress	25,877
Total	1,011,289

Trade and other receivables

Ticket sales form the bulk of the revenue. Sponsorship and advertising income have increased fairly significantly over the last three years. Efforts are being taken to manage the trade receivables within acceptable levels. A break-up of trade and other receivables as at 31 March 2018 is given below.

	Amount (Rs. '000)
Trade receivables	55,774
Advances and prepayments	29,801
ESC recoverable	4,500
WHT recoverable	1,759
Total	91,834

The debtors' ageing report shows long-outstanding debtors exceeding 365 days from franchised theatres and sponsorships. Although the accountant has stated that a provision needs to be made the marketing director has insisted that these debts can be collected.

Loans and borrowings

Investment in CAPEX in the last few years was funded through bank loans. The bank loans appearing under current and non-current liabilities are from private sector banks. Corporate guarantees have been issued by TWPL and the existing land and buildings owned by the company have also been pledged to a certain extent.

The interest rates of the three loans obtained range from 15% to 18%. The chairman of TWPL is of the view that the treasury function of the company is very weak. It must also be noted that borrowings of the company have steadily increased over the last few years.

A bank that had lent funds to TWPL has written to the chairman expressing grave concern regarding the delay in getting the financial statements audited.

The financial information of TWPL is given in Annexure 3.

Marketing strategy

The customers of TWPL are key to its success. The company hopes to provide its patrons a variety of options when it comes to films, in the form of different genres, and a multiplex theatre experience is also being considered for small and medium cinema halls. In addition the marketing director also wants to introduce a loyalty card in order to retain existing customers and offer discounts to loyal patrons. A season ticket has already been introduced where the holder is entitled to watch 5 movies at a special reduced rate. The company sells e-tickets through its website.

Financial benchmark figures of a similar listed company

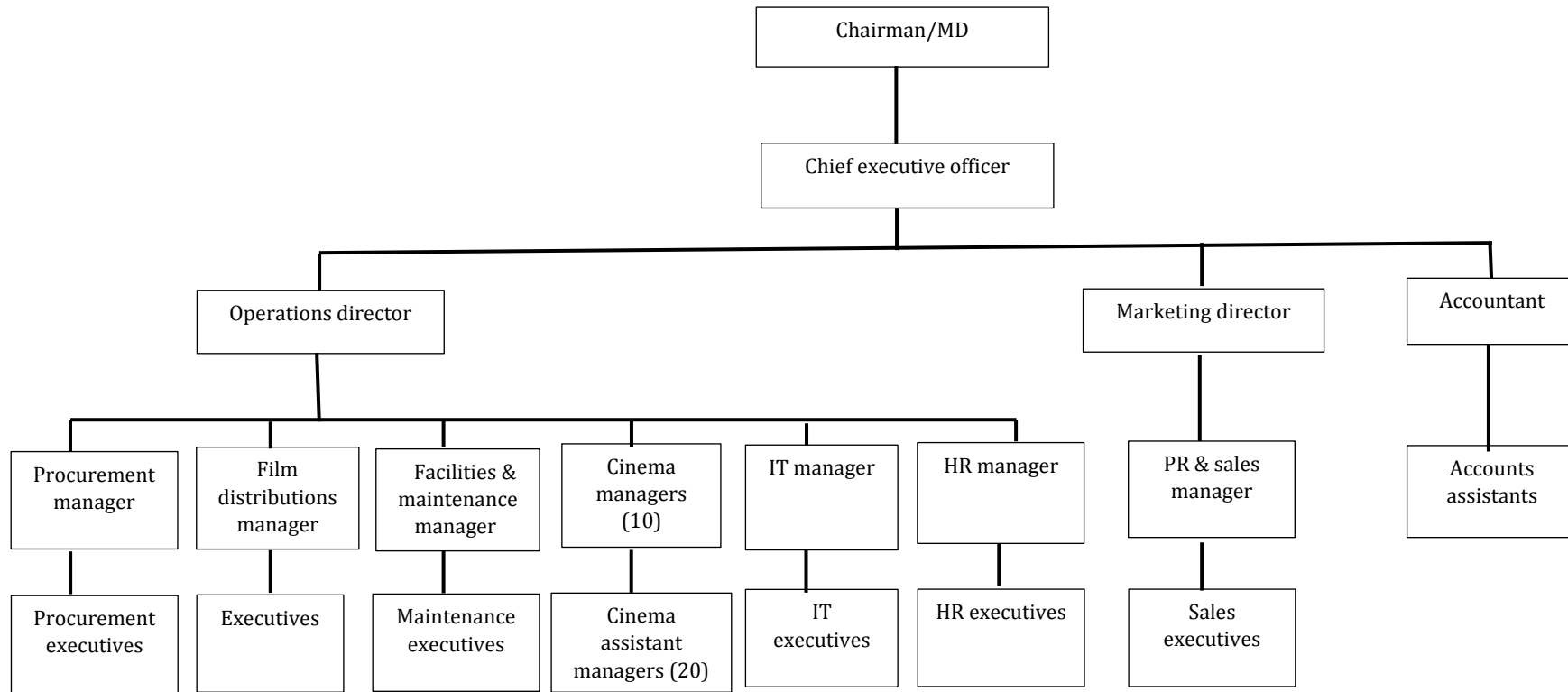
Z PLC, which is listed on the Colombo Stock Exchange, reported the following results. These figures may be of use for a valuation of the shares of TWPL.

- Dividend payout ratio: 15%
- Earnings per share (EPS): Rs. 14.50 (issued at Rs. 10 per share)
- Z PLC was funded with a debt to equity ratio of 40:60
- Market price per share: Rs. 22
- Beta (based on ASPI): 0.60
- Current treasury bill rate: 9.5% per annum
- Market risk premium: 3.5%
- Market rate of return: 13% per annum

Annexure 1: Qualifications and experience of the senior management team of TWPL

Name	Designation	Age	Qualifications
Nihal Fernando	Chairman/Managing director	55	BA (Arts), MSc (Theatre and Film)
Charith Perera	Chief executive officer	54	BA (Arts), Diploma in Interior Design
Nuwan Perera	Marketing director	28	BSc (Digital Marketing)
Lakshmi Fernando	Operations director	32	BSc, MSc (Logistics)
Siraf Sally	HR manager	31	Diploma in HR
Anna Alwis	Accountant	28	FAAT, Part qualified in CA
Dasun Palihakkara	Engineering manager	45	BSc (Eng), MIEI
Nayana Gamage	IT manager	32	MCSE, OCP
Chammi Silva	Procurement manager	26	Diploma in General Administration

Annexure 2: Organisational structure of TWPL



Annexure 3

Theatre World (Pvt) Ltd

Statements of profit or loss and other comprehensive income

For the year ended 31 March	2016	2017	2018
	(Unaudited)	(Unaudited)	(Unaudited)
	Rs.'000		
Revenue	455,268	660,139	528,654
Cost of sales	(250,391)	(363,076)	(248,765)
Gross profit	204,877	297,063	279,889
Other income	45,435	67,575	54,646
Net gain/(loss) on investments at fair value through profit or loss	(6)	(65)	(81)
Administrative expenses	(182,501)	(200,795)	(219,667)
Selling and distribution expenses	(45,568)	(50,001)	(53,191)
Results from operating activities	22,237	113,777	61,596
Finance income	6,765	7,599	9,564
Finance costs	(35,549)	(49,972)	(68,374)
Profit/(loss) before tax	(6,547)	71,404	2,786
Tax expense	-	(19,680)	(780)
Profit/(loss) after tax	(6,547)	51,724	2,006
Actuarial gain/(loss) on retirement benefit obligation	-	-	-
Total comprehensive income/(loss) for the year, net of tax	(6,547)	51,724	2,006
Number of shares	1,500,000	1,500,000	1,500,000
Earnings/(loss) per share (EPS)(Rs.)	(4.36)	34.48	1.34

Theatre World (Pvt) Ltd
Statements of financial position

As at 31 March	2016	2017	2018
	(Unaudited)	(Unaudited)	(Unaudited)
	Rs.'000		
Assets			
Non-current assets			
Property, plant and equipment	778,323	885,765	1,011,289
Intangible assets	2,500	2,250	2,000
Investment property	3,500	3,500	3,500
Investments	20,000	22,568	25,464
Loans to PHPL	15,500	13,500	41,178
	819,823	927,583	1,083,431
Current assets			
Inventories	7,506	10,534	8,764
Trade and other receivables	85,051	95,738	91,834
Investments	35,001	52,852	60,765
Amount due from related companies	62,599	52,336	41,354
Cash and cash equivalents	15,055	29,485	35,645
	205,212	240,945	238,362
Total assets	1,025,035	1,168,528	1,321,793
Equity and liabilities			
Equity			
Stated capital	150,000	150,000	150,000
Revaluation reserve	200,304	200,304	200,304
Retained earnings	233,873	285,597	287,603
Total equity	584,177	635,901	637,907
Non-current liabilities			
Loans and borrowings	178,432	225,565	325,000
Employee benefits	6,549	6,017	7,769
Deferred tax liabilities	27,654	35,646	37,645
	212,635	267,228	370,414
Current liabilities			
Trade and other creditors	46,049	60,731	76,098
Accrued expenses and other payables	111,998	112,867	119,943
Loans and borrowings	44,608	80,433	101,465
Taxes payable	-	2,577	3,501
Bank overdraft	25,568	8,791	12,465
	228,223	265,399	313,472
Total equity and liabilities	1,025,035	1,168,528	1,321,793

Theatre World (Pvt) Ltd
5-year forecast

	2018/19	2019/20	2020/21	2021/22	2022/23
	(Rs. '000)				
Revenue	633,601	748,641	880,938	1,033,079	1,208,040
Cost of sales	(285,120)	(327,888)	(377,072)	(433,632)	(498,677)
Gross profit	348,481	420,753	503,866	599,447	709,363
Other income	69,696	82,351	96,903	113,639	132,884
Net gain/(loss) on investments at fair value through profit or loss	(58)	(35)	(40)	(21)	(15)
Administrative expenses	(221,760)	(255,024)	(293,278)	(337,270)	(387,860)
Selling and distribution expenses	(63,360)	(72,864)	(83,794)	(96,363)	(110,817)
Results from operating activities	132,999	175,181	223,657	279,432	343,555
Finance income	14,617	16,079	17,687	19,456	21,401
Finance costs	(92,676)	(116,485)	(139,783)	(167,739)	(201,287)
Profit before tax	54,940	74,775	101,561	131,149	163,669
Tax expense	(15,383)	(20,937)	(28,437)	(36,721)	(45,827)
Profit after tax	39,557	53,838	73,124	94,428	117,842