PFL

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March 31, 2020

To,
National Stock Exchange of India Limited
Listing Department
Exchange Plaza,
Bandra-Kurla Complex
Bandra East, Mumbai - 400 051
Fax Nos.: 26598237 / 26598238

To,
BSE Limited
Listing Department
Phiroze Jeejebhoy Towers,
Dalal Street,
Mumbai - 400 001
Fax Nos.:22723121/2037/2039

Dear Sir/Madam,

Ref.: Scrip Code: BSE – 532748/NSE – PFOCUS

Sub: Credit Rating Intimation under Regulation 30 of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015

This is to inform you that Indian Ratings and Research (Ind-Ra), the credit rating agency, has downgraded Prime Focus Limited's (PFL) Long-Term Issue Rating to 'IND BBB' from 'IND BBB+' while revising the rating watch to Rating Watch Negative (RWN) from Rating Watch Evolving (RWE). The instrument-wise rating action are as follows:

Instrument Type	Maturity Date	Size of Issue (million)	Rating / Rating Watch	Rating Action
Term Loans	December 30, 2023	INR 1,910	IND BBB/RWN	Downgraded; Rating Watch Revised to Negative from Evolving
Fund-based working capital limits	-	INR320	IND BBB/RWN/IND A2/RWN	Downgraded; Rating Watch Revised to Negative from Evolving
Non-fund-based working capital limits	-	INR140	IND A2/RWN	Downgraded; Rating Watch Revised to Negative from Evolving
Stand-by letter of credit (LC)	-	INR2,618	IND A2/RWN	Assigned; placed on RWN

As per the credit rating agency, the downgrade reflects PFL's weakened leverage profile amid rising debt levels and a challenging operating environment, with the company's under-performing technology business moderating strong margins from the creative services business. The RWN takes into account the ongoing deleveraging initiatives intimated to the agency by PFL so as to strengthen the balance sheet. Contingent upon the success of these initiatives, the rating could be either affirmed or downgraded.

Consolidated View: Ind-Ra continues to take a consolidated view of PFL and its principal subsidiaries, including Prime Focus Technologies Limited (PFT; 'IND BBB+'/RWE) and DNEG Creative Services Limited (DNEG; 'IND BBB+'/RWE), on account of the strong legal, operational and strategic linkages among them. As of December 2020, PFL held an equity stake of about 73.8% in PFT and of 80% (on a fully diluted basis) in DNEG. Also, there are cross guarantees and cross collateralisation between PFL, PFT and DNEG.

FOLLOWING ARE THE KEY RATING DRIVERS AS REFERRED BY THE CREDIT RATING AGENCY:

Consolidated Leverage Remains Weak; Deleveraging Efforts Continue: The consolidated leverage profile has deteriorated due to the increasing debt on the books of PFL amid weak EBITDA margins and a delay in infusion of additional capital. The net debt/EBITDA was 6.60x in FY19 (FY18: 4.22x; FY17: 3.51x) and the net debt was INR24 billion (INR16 billion; INR12 billion). It rose further to INR27 billion in 9MFY20. Gross interest coverage (EBITDA/interest coverage) stood at 1.4x in 9MFY20 (FY19: 1.7x; FY18: 1.7x). The agency is monitoring PFL's deleveraging efforts and an outcome on this front will be key to resolving the RWN over the Next few months.

Weak Margins amid Elevated Expenses: EBITDA margins for PFL dipped in 9MFY20 to 12% (9MFY19: 13%) mainly due to a non-cash Employee Stock Ownership Plan (ESOP) charge taken in 3QFY20. Adjusting for this, 9MFY20 EBITDA margin came at 16%, higher than the 13% reported in 9MFY19. The weakness in reported EBITDA margin was mainly on account of 1) increased employee costs, 2) non-cash ESOP charges, and 3) inability of the technology business to scale and become profitable due to integration challenges with major US clients. However, PFL's revenue run-rate continued to improve in 9MFY20, as the order book, especially for the creative services division, remains robust.

COVID-19 Outbreak adds Uncertainty to Outlook: The recent global COVID-19 outbreak may lead to movie releases being deferred and could impact the work delivery schedule for PFL, especially if the shutdown of the movie industry lasts long (couple of months than weeks). However, PFL's exposure to this risk is mitigated as its key customers include several large well capitalised studios, minimising receivable issues. Also, PFL can resort to cost cuts (such as rationalising some of the work force) to conserve liquidity and profitability. Ind-Ra shall continue to monitor the situation and its resultant impact on PFL's liquidity and financial position.

Continued Market Leadership: PFL has a market leadership position in the 2D-3D conversion market and an established position in the post production services and visual effects market. Also, it has a robust order book size of over USD200 million at the key creative services division, bulk of which is to be executed over the next nine to twelve months. While revenues have largely been driven by the creative services business, PFL will continue to benefit from its potentially high growth technology business as well which has been facing slow pace of contract renewals recently. PFL's revenue grew to INR21 billion in 9MFY20 (FY19: INR25 billion). Ind-Ra estimates FY20 revenue growth should be 8%-10% yoy, on the back of a number of marquee projects in FY20 reaching their conclusion.

Liquidity Indicator - Stretched: Ind-Ra assesses PFL's liquidity situation as stretched, given substantial repayments amounting to INR2 billion in FY20 and INR2.1 billion in FY21. Additionally, due to the high leverage, interest expense payments in FY20-FY21 too are expected to be in excess of INR2 billion. While PFL reported cash on consolidated balance sheet at end-1HFY20 of INR1.7 billion, the group's free cash flow generation trend has been negative in the last few years due to capital expenditure related to opening of new offices. Also, operating challenges for PFL's technology business remain high, amid the soft revenue momentum and weak operating margins. PFL has substantial undrawn credit lines across its international subsidiaries, amounting to roughly INR5.2 billion which should help alleviate any near-term funding issues. However on an ongoing basis, sustaining healthy liquidity is now tied closely with strengthening of the balance sheet.

Margin Improvement on a Standalone Basis: PFL's EBITDA margins jumped to 33% in 9MFY20 from 13% in FY19 and EBITDA increased to INR0.3 billion from INR0.21 billion, on account of a large reduction in overall employee and ESOP expenses. In 9MFY20, revenues were INR1.03 billion, as against FY19 revenues of INR1.6 billion. The credit metrics are weak when analysed on a standalone basis, with the company reliant on cash flows from its subsidiaries to service debt and interest payments.

Structural Subordination: Cash flows from the overseas subsidiary PFW may not be readily available to service debt at the standalone level. Also, PFT and PFW have substantial non-promoter shareholdings that constrain the free upstream of surplus cash flows.

The press release on the same vide dated March 30, 2020, has been published by India Ratings & Research on their website viz. www.indiaratings.co.in.

This is for your information and records.

Thanking You,

For **Prime Focus Limited**

Sd/-

Parina Shah
Company Secretary & Compliance Officer