Alternative Financing Options

With the finance markets continuing to open up, **EFA Partners** offers exhibitors a few more specifics on d-Cinema financing alternatives, including large senior debt financings, leasing options and government-backed programs.

This summer's animated 3D blockbuster, *Toy Story 3*, is all about options during a time of turmoil. Woody, Buzz Lightyear and buddies know a radical change is afoot as their owner, Andy, heads off to college. Either they'll be placed in the attic or else thrown out with the garbage. The gang becomes frantic, and Rex – the ever-anxious dinosaur – blurts, "*I hate all this uncertainty!*" However, as the story unfolds, they learn of other encouraging options.

Similarly, Exhibition is in the midst of a radical change as the d-Cinema conversion continues. Small- and mid-sized exhibitors may feel that options for financing digital equipment are extremely limited. While this was recently the case, there are now more viable financing alternatives as regional and national lenders, also equipment lessors, have begun to better understand the digital conversion, the equipment involved and the VPF concept.

Most lessors wouldn't consider leasing d-Cinema equipment due to uncertainty in the digital conversion and the projectors being a new asset class. This is no longer so… lessors now appreciate digital projectors to be dependable, critical assets, and understand that VPFs can be available for lease-repayment.

As exhibitors study the various financing paths, they should be having simultaneous discussions with d-Cinema integrators and equipment suppliers to finalize VPF agreements – a critical part of the credit-approval process. Throughout, exhibitors should stay composed and heed the advice of Buzz as he attempted to calm his friends, imploring, "*This is no time to be hysterical!*"

SENIOR DEBT FROM LARGER FINANCIAL INSTITUTIONS

Many exhibitors currently have relatively small loans from local banks in their community. As these exhibitors expand via acquisition, constructing new sites and digitizing existing theatres, they'll likely outgrow the limits of the community lender. As such, exhibitors could explore financing alternatives with regional and national financiers. Many are gaining a better understanding of the Exhibition industry's d-Cinema conversion and, unlike local banks, which have difficulty with loans over $5m, larger institutions pursue loan opportunities in the +$15m range. Exhibitors can seek overall financing solutions with such lenders that could encompass d-Cinema assets, refinancing existing loans and growth capital.

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Of course, loan terms can vary greatly depending upon the exhibitor's creditworthiness. Loan facilities may be structured as a single loan with two components: a loan based upon theatre cashflow generated by the exhibitor and a d-Cinema loan based on the VPFs generated by such equipment. For the cashflow component, the term typically ranges from three-to-five years with a loan amount at three-to-four times annual theatre cashflow. For the d-Cinema component, the facility could be five-to-seven years with a loan amount of 80-90pc of the digital equipment cost that would be repaid from the VPFs. Interest rates for both types will float anywhere from 3-7pc over a base rate (such as LIBOR), with upfront fees of 1-2pc. Don't be surprised if higher rates and fees are expected specifically for the d-Cinema component.

While these loans are excellent vehicles to assist small- to mid-sized exhibitors expand and compete in today's market, there are issues to consider when negotiating loan documentation. Key among them include financial covenants, such as minimum annual cashflow thresholds, which must be met or the loan could be in default. Owners' personal guarantees may also be requested. Accordingly, this type of loan can help qualified exhibitors leap to the next level.

LEASING ALTERNATIVES

For exhibitors specifically seeking to finance their d-Cinema equipment, leasing options have become much more prevalent. Even in recent years, most lessors would not consider

leasing d-Cinema equipment, mainly due to the uncertainty in the digital conversion, but also because of the projectors being a new asset class. This is no longer so. Lessors now understand digital projectors to be dependable, critical assets, while understanding that VPFs can be available for lease-repayment.

Depending on your objectives, leasing can help in managing monthly cashflow. Up to 90pc of the equipment cost can be financed with typically low monthly payments because much of the repayment is due at lease termination. Financing rates can range from 5-8pc on the low end, to well over 12pc depending on end-of-lease options. Upfront fees are typically 0.5pc or less, while lease terms can be four-to-seven years.

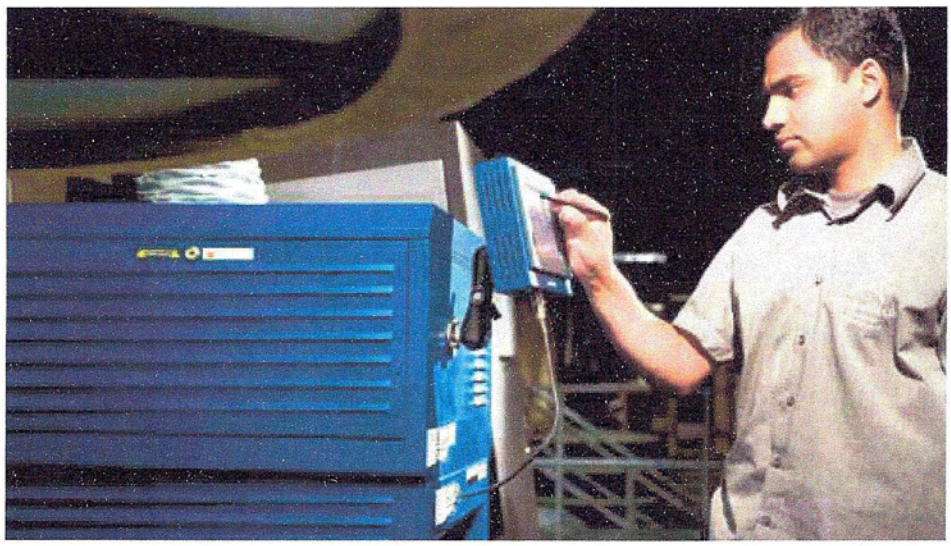
From an accounting perspective – and while treatment varies by country – operating leases allow that the lessor retain equipment ownership so that the lease is not recognized on the exhibitor's balance sheet. This may be attractive for some exhibitors.

When negotiating a lease, there are several considerations with end-of-lease options near the top of the list. Many leases offer the exhibitor an option to purchase the equipment at lease-end at its fair market value. In such instances, leases should include a clear methodology to determine fair market value such as the average values from two independent appraisers. Additionally, many lessors will consider capping the fair market value amount at a percentage of the equipment cost. With several lessors seeking d-Cinema business, a competitive market exists with viable leasing opportunities available to most exhibitors.

GOVERNMENT-BACKED PROGRAMS

More recently, there have been various government-assisted programs for d-Cinema financing. These programs have varied by country with certain programs tailored for smaller exhibitors struggling the most to obtain d-Cinema financing. In the U.S, such programs include those backed by the Small Business Administration (SBA), although the SBA is not a lender. Its role is to provide participating banks and finance companies with loan-guarantees of up to 90pc of the loan amount as an inducement to make loans otherwise unavailable on terms favorable to smaller businesses. SBA-backed facilities can be attractive because they can finance up to 100pc of the d-Cinema conversion cost with 10-year mortgage-style amortization financing and interest rates floating at 2.75pc above the Prime Rate. Maximum loans are $2m – sufficient to convert over 25 screens. Program administration fees remain quite low at about 2pc of the equipment cost.

Since they are targeted to smaller businesses, only certain exhibitors qualify for SBA-backed loans. Businesses must have a maximum net worth of $8.5m and maximum annual net incomes of $3m. Owners' personal guarantees are often necessary, and minimum personal credit scores can also be required. While not every exhibitor will meet these requirements, a significant number of qualifying U.S. exhibitors should explore this option.



IN SUMMARY

More lenders and lessors are starting to understand the d-Cinema conversion, recognizing that digital equipment-financing represents a tremendous opportunity for those willing to put in the effort. They have learned that d-Cinema projectors are dependable as well as critical exhibitor assets. Thus, financing alternatives are now available in the form of:

(a) debt financings that incorporate d-Cinema equipment and other exhibitor needs
(b) various leasing alternatives, and
(c) government-backed programs that provide guarantees for the lenders.

Exhibitors should explore each of these options with multiple financing sources to obtain appropriate finance and should work hand-in-hand with d-Cinema integrators and equipment suppliers to ensure VPF agreements are in place. The process may not be as restrictive as exhibitors fear and they should take the advice of *Toy Story 3*'s Buttercup when he tells Woody, "*Just stay loose, have fun and you'll be fine.*"

EFA Partners *(Kenneth Favre, Ralph Willis, Brandt Gully), based in New York and Atlanta, is a specialized advisory and consulting firm focused on providing financial services to the Film & Leisure sectors, providing advice on raising capital, M&A, restructurings, and general business strategy.*
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