FINANCING DIGITAL CINEMA

Ralph Willis, **Brandt Gully** and **Kenneth Favre** of EFA Partners LLC, assess the impact of frozen credit markets on d-Cinema financing, also how exhibitors across-the-board can improve their situation.

In the movie *The Day After Tomorrow*, there's a series of scenes in which weather experts suddenly realize their previous forecasts were off – *way* off. What they'd predicted would happen over the next several years suddenly happened in just days, producing the second Ice Age. Lead character Jack Hall implored government officials, "I think we are on the verge of a major climate shift!" An understatement.

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Similarly, recent freezing of the credit markets went largely unpredicted by analysts and remarkable economic events occurred week after week in 2008-09. It was truly historic to have witnessed the collapse of so many major financial institutions. In some respects, the credit crisis positively impacted the film industry which, for decades, has fared well in a downturn. 2009 was no exception, with the North American box office notching up a record $10.6bn. Going to the movies has been, and remains, relatively inexpensive entertainment. But it wasn't all great news as tightening credit markets and a reduced number of lenders made it difficult for exhibitors to borrow under acceptable terms.

LOAN REVISIONS

So, is there some light at the end of tunnel? Potentially so, as many believe the credit markets to be partially thawing, driven by financial institutions seeking to meet new budgets and goals for 2010. And with the film industry's recent strong performance, lenders should view the sector favorably. Of course, exhibitors don't all have the same financing objectives. Some seek to revise existing loan terms, while others need new ones either for growth or refinancing. Furthermore, Digital Cinema financing has spawned a whole new set of complexities and, for each of these, exhibitors need to be aware of the lending landscape.

For exhibitors interested in revising loan terms, lenders are willing to discuss agreement modifications; however, in contrast with previous years, approval may take longer and fees may be higher. Indeed, in the current economic climate, there may be significant costs for almost any type of loan agreement revision. In the past, there would be little or no fee associated with a minor loan issue, such as requesting extra time to deliver financial statements. Today, any fee likely will be much higher. Lenders may also want to revisit interest rate increases. So, unless business circumstances necessitate loan revisions, it may be best to wait for a more friendly lending environment.

NEW LOAN CRITERIA

For new loans, exhibitors should be realistic. First, with fewer financial institutions around, of those still in business, many remain more focused on managing existing portfolios than on looking for new business. Second, lending parameters are now much tighter – lenders once willing to lend four to five times annual theatre cashflow may have since reduced lending multiples to just two or three. Third, while interest rates are low, floating rate loans will now most likely have a "floor" rate, resulting in borrowers not seeing the benefit of an interest rate reduction. Lenders also expect higher upfront loan fees, perhaps double those of previous levels. Lastly, lending terms typically will be shorter right now. Lenders once offering seven-year loans may now be comfortable with just five-year terms.

D-CINEMA FUNDING

The topic on most exhibitors' minds of late has been the Digital Cinema conversion. With only 8,000 screens converted in North America, they will have wondered both when and how additional financing will be available. For the big three circuits – Regal, AMC and Cinemark – the answer seems clear with the formation of DCIP for the conversion of their 14,500 screens. JP Morgan Chase is leading the financing, garnering interest from the Banking community. For other operators, Cinedigm could be the answer, with their announced financing led by GE Capital and Société Générale for the conversion of over 2,100 screens. For the remaining 14,000 screens, the industry will need over $1bn additional financing.

Where will these dollars come from? First, it's unrealistic to think that all 39,000 North American screens will all convert *that* soon. Many exhibitors do not have a desire to convert 100% of their screens, and may convert only one or two per site for 3D and Alternative Content. Second, smaller circuits may not want to wait for inclusion in the DCIP or Cinedigm financing facilities, as those most likely will go to larger and mid-sized exhibitors.

Ultimately, many exhibitors may choose to finance Digital Cinema equipment in-house, electing to utilize "direct-to-exhibitor" offerings, like from Paramount and Cinedigm. Depending on the financing needed, local and regional lenders continue as good sources. Loans for the conversion of 50-100 screens (up to approximately $8m) should be in the sweet-spot for local lenders; and, for larger financings, lenders may partner with other regional ones. However, since many local lenders lack experience in the theatre industry, exhibitors must prepare to take time to explain Digital Cinema and the associated industry benefits.

2010 AND BEYOND

What's predicted for 2010 and beyond? Well, ask 20 analysts this question and you'll get 20 different answers, though, it's true, many now feel the markets to be thawing. And, as they do, the Cinema industry's excellent recent performance should well-position exhibitors to access their fair share of lending dollars. To quote Jack Hall again, "Mankind survived the last ice age… we're certainly capable of surviving this one." S

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