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CINEMA

[STILL] RECLINER TIME

The recliner-seating revolution has certainly come far in the last five or so years, and while significant numbers of theatres *have* thus far committed, it's true that many are still in decision-making mode. However, explains boutique financial advisory firm, **EFA Partners**, that far from being too late, today could actually represent an even more opportune time to convert.

By now, everyone even remotely involved in film exhibition is familiar with recliner seating. The sector has progressed nicely over the past few years, and most feel it has dramatically changed the movie-going experience. So what's next? Is it safe to assume that almost all theatres have converted to luxury recliners so it's now time to think about other new technology? Maybe further roll-outs for laser projection or LED screens? Well, maybe not so fast.

While many theatres have converted to recliners, especially in the U.S, it's also true that other exhibitors are still deciding if it's the right move for some or all of their theatres. Thus, we still often find ourselves, at EFA Partners, fielding such questions as: "Should I convert?" and "How do I finance it all?" Of course, there is no simple answer for either of these.

THE CONVERSION DECISION

It seems there would be a consensus on recliners in cinemas now that we've had the opportunity to see several years of results. Patrons seem to be giving a thumbs-up to the more comfortable chairs, but some exhibitors still aren't sure if a conversion is the right move. There are many factors to consider, including the size of the market, the size of your theatre(s) and the nearby competitive environment. Assuming a competitive market, industry results have shown that the first theatres to convert have an advantage as patrons can become loyal followers enjoying a superior viewing-experience. On the other hand, there are plenty of instances in which operators have waited and then installed something better than the competition only to see lost customers return.

Many operators have deemed their theatres or markets to be too small to justify losing seats or incurring conversion-costs, while some conclude that recliners have helped them grow the local customer market and even to justify higher admission-prices. And sometimes it's true that exhibitors who delay the recliner decision may still ultimately need to convert in order to prevent losing further marketshare.

The decision can be even more complex for exhibitors planning on selling their businesses. On the surface, it seems logical that upgrading theatres would better

FINE-TOOTH COMB
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position a business that will be for sale. And, while that can be the case, recent experience with our M&A clients has challenged that notion. Certain prospective buyers prefer to handle the upgrade process themselves utilising their own designs and funding, the strategy enabling them to purchase the theatres for a lower cashflow-multiple than, say, already-converted theatres. They feel this allows them to better reap the benefits of increased profitability. As such, these exhibitors may not bid so aggressively on theatres that have already seen a recliner-upgrade.

YOUR FINANCING STRATEGY

The major exhibitors typically enjoy ample access to capital to upgrade theatres with luxury recliner seating and other amenities, as has been demonstrated by AMC, Regal, Cinemark and others. The conversion may be more difficult for smaller exhibitors with more limited financing-resources. Solutions can come from a variety of sources which includes not *only* banks, but also landlords, equipment-financiers and specialty lenders.

From our previous articles, readers will know how we stress the 'preparation of comprehensive materials' when approaching lenders. Materials should include historical financials (for each theatre, and consolidated); design-renderings, projections, industry data demonstrating the benefits of recliners; territorial descriptions for each theatre, an overview of competition in each territory, and other information that highlights the circuit and its recliner-benefits. It can be counter-intuitive to lenders that reducing seats will increase profitability, but data can now support this compared with previous years when recliner-installs were in their infancy.

When budgeting for a recliner conversion, it's often the case that other upgrades will comprise part of the overall plan, an example being a lobby-renovation or enhancement of F&B offerings with the addition of a kitchen and/or bar. Assuming reasonable budgets and projected increased profits, financiers seem to take a favourable view of upgrades that enhance the entire patron-experience.

The type of financing group to approach varies with each situation, and we often recommend a multi-pronged strategy. The traditional banking market continues to be a good financing-source amid the current economic environment, with relatively low interest rates,

EFA's Funding Source Differentiation Table

Source	Pros	Cons
Banks	Low interest rates (4-6%)	Less flexible
	Longer amortization (5-20 years)	Need Personal Guarantees (PGs)
Equipment Financiers	Relatively low interest rates (6-8%)	Will not fund cosntruction/ soft costs
	Often will fund all equipment (recliners and others)	Shorter amortization (4-7 years)
Specialty Lenders	More flexible for funding growth projects	Higher interest rates (10-12%)
	Low amortization (can be interest-only)	Need larger companies (EBITDA of +$5m)
Landlords/ REITs	Incented to increase property values	Long-term rent increase
	No new debt as repayment is via rent increases	Will not fund equipment

although the banks are not always flexible with financing terms and often need personal guarantees (PG) from owners.

Many equipment-financiers are now more comfortable with recliner seats given the data supporting their recent success. Financing terms are relatively short at five-to-seven years, and interest rates are typically higher than offered by the banks. While some equipment-financiers are fine with providing financing for all equipment-types, others may be more selective and may limit funding to certain equipment with which they remain more familiar.

Landlords are often good resources for funding upgrades, through tenant-improvement allowances. Their interests are aligned with the operators' since improvements to the customer-experience should result in stronger revenues and higher rent-paying tenants, in most cases. While this can result in increased rent, it is often the most seamless way of funding renovations with economics that are comparable to traditional financings.

Specialty lenders are a further option. While they are more expensive than other financiers, they can represent an attractive source of capital for companies with significant growth-plans. Terms are typically four-to-five years with very low annual amortisation and, in some instances, can be interest-only.

NEVER TOO LATE

If you are one of the hold-outs that has seen nearby competitors spend the money and undergo the above upgrades, you may be left wondering if it's now too late for you to adapt. We have seen many of our clients fight this after sitting on the sidelines, watching others be more innovative and gaining marketshare. However, despite arriving late to the party, many have seen that marketshare coming right back after matching – or even one-upping – their competitors with comparable, and sometimes better, upgrades. One example of a smaller U.S. exhibitor whom we know very well is The Springs Cinema & Taphouse, located in Atlanta, GA. The theatre is operated by our very own Brandt Gully, a partner at EFA, who recently took on the role of exhibitor.

As an advisor to film exhibition for many years, he understands the industry-dynamics as well as the hands-on approach needed for procuring financing. So, when the opportunity arose to acquire an outdated – and struggling, though once-popular – theatre near his home, he took a methodical approach to applying much of what he's seen our clients do with renovations over the years.

"I've heard clients say for years that it's 'all about location'", declared Brandt, who knows the area very well from living just down the road. "Despite the poor condition and declining attendance at this once-beloved local independent theatre, I knew this was a fantastic location… and just needed a complete makeover because people still love the movies and they just want a better experience than they can get elsewhere".

After a year of spending SBA loan-proceeds to rebrand the theatre, install the area's *only* heated luxury recliners, overhaul the projection and sound systems, redesign the lobby, add a full bar and enhance the kitchen, the results have been stellar. Despite the overall industry seeing a box office decline, The Springs saw both attendance and food/beverage *per caps* increase by over 100%. This is in a dense and very competitive market boasting over eight theatres within a seven-mile range, most of which had *already* upgraded to recliners and featured some sort of enhanced F&B-offering.

As an industry financial advisor, Brandt knew how to approach the lending market. Having contacted several lenders and taking them through a presentation that detailed the theatre's potential, this resulted in obtaining a favourable bank loan to fund the entire renovation.

When budgeting for recliner conversions, other upgrades will often also comprise part of the plan, such as a lobby-renovation or F&B-enhancement... assuming reasonable budgets and good projected profits, financiers will take a favourable view

IN SUMMARY

The Motion Picture industry has continued to evolve, and exhibitors have shown resiliency as more and more home entertainment options emerge. This has resulted in recliner-seating become a very prevalent feature, rather than, for example, a nascent niche amenity. The seating has demonstrated that it can dramatically change the mindset of consumers when they are choosing whether to venture to theatres (and indeed *between* theatres) or to stream-at-home. Given that there is now more history with recliners resulting in success, the good news is that financiers should be more willing to review conversion plans for those that are still in decision-making mode.

***EFA Partners** provides investment banking services focused on arranging capital, M&A, and providing analytical reports and financial consulting services for entertainment, media and technology companies.*
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