

Virtual Print Fee Basics

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April 2017



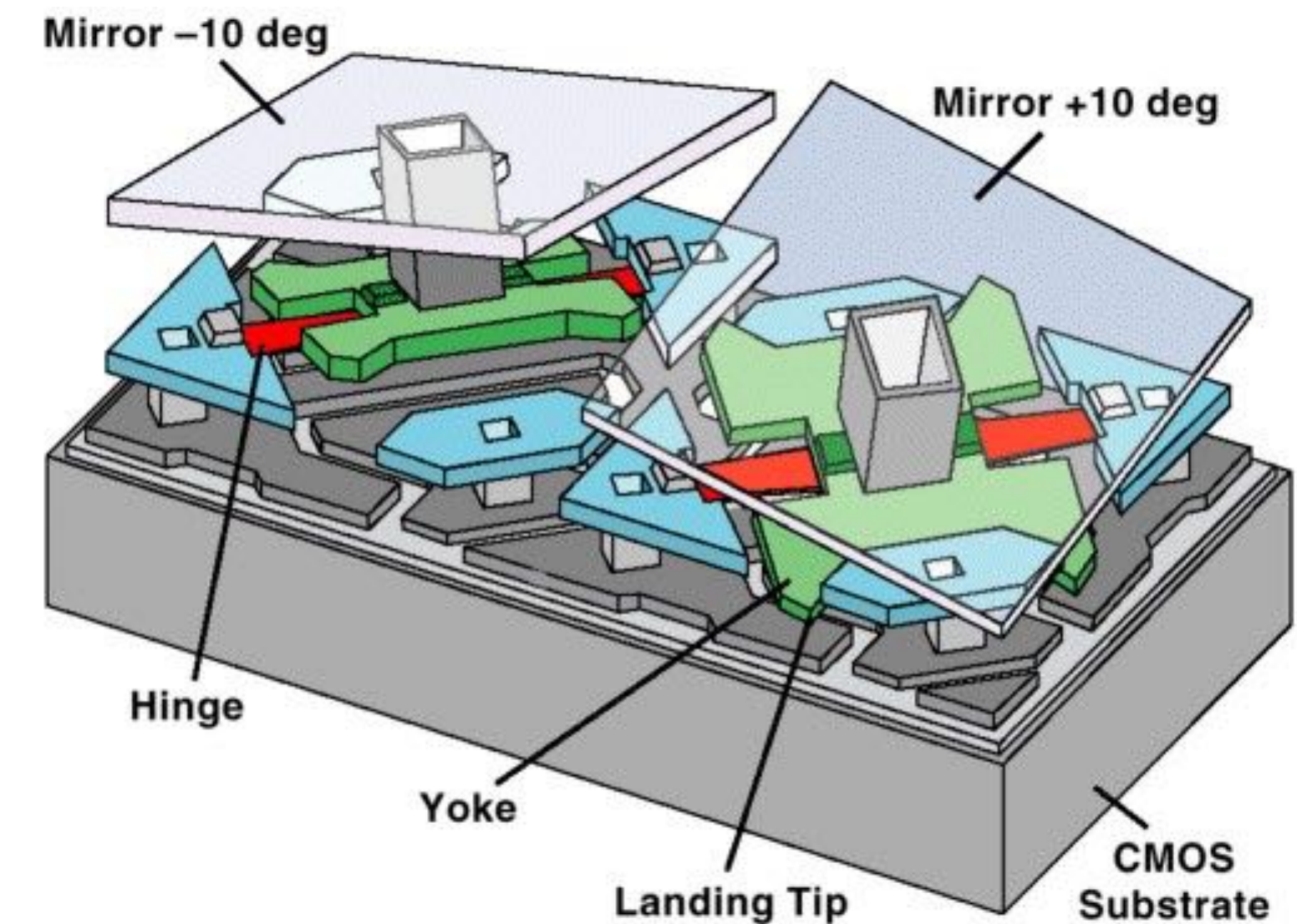
Economics Of Digital Distribution

- Wide release movies typically require 1000-4000 prints
- Film print ~ \$1500
- Digital print ~ \$300
- Studio savings ~ \$850M per year (US)
- Exhibitor capex ~ \$3B (US)
- **VPF Subsidy = Studio savings towards Exhibitor capex**



If It's So Good, Why Did It Take So Long?

- ❑ Texas Instruments DLP technology emerged late 90's.
- ❑ DLP was a breakthrough: true digital modulation of light.
Color is extremely stable and repeatable.
Perfect replacement for film.
- ❑ DLP enabled the transition.
Without it, the transition would have been delayed until a viable solution appeared.
- ❑ Other display technologies also emerged, but TI was the driver.



There Were Hurdles to Cross

- No reason for exhibitors to invest.

Digital projection is a replacement technology, not a generator of new revenue. Distributors save, Exhibitors spend, creating a financial imbalance.

The Virtual Print Fee subsidy overcame the financial imbalance.

- High risk of investment.

Hollywood-driven technology rollouts can be risky (HD-DVD vs Blu-Ray).

Why would this be different?

The answer was Digital Cinema Initiatives (DCI), a JV of the major studios.

- Multiple technology issues.

Digital distribution needed to be secured to get all content owners on-board.

The high quality of film must be matched to get creatives on-board.

DCI and SMPTE addressed technology issues. The ASC was engaged for quality.

Launch Year Was 2005

- DCI released its Digital Cinema System Specification.
- First Virtual Print Fee agreements signed with Access IT (now Cinedigm) and Technicolor.

Digital Cinema Initiatives (DCI) Announces Final Overall System Requirements and Specifications for Digital Cinema

Agreement Gives Manufacturers of Digital Projectors and Theater Equipment One Universal Standard in Creating the Next Generation of Cinemas

Jul 27, 2005, 01:00 ET from Digital C...

HOLLYWOOD, C...
(DCI) h...

06.21.2005 Access Integrated Technologies and Christie Digital Systems Sign Ground-Breaking Agreement For Digital Cinema Rollout Plan Targeting 2,500 Screens Within Two Years

- Newly Created Funding Vehicle, A Digital Cinema Industry Milestone, Features Minimal Cost to Exhibitors -

MORRISTOWN, N.J. – June 21, 2005 – In a major move designed to accelerate the long-awaited implementation of Digital Cinema nation-wide, **Access Integrated Technologies, Inc. ("AccessIT") (AMEX: AIX)** and Christie Digital Systems, USA (Christie) today jointly announced a preliminary agreement to create the movie industry's first practical Digital Cinema funding framework. The plan satisfies the diverse concerns of movie studios and exhibitors by standardizing content format, delivery and presentation. It minimizes financial risks for studios and exhibitors by establishing an innovative template that allows private investment in the burgeoning Digital Cinema industry. The agreement includes a two-year plan for a 2,500-screen rollout, with over 200 screens to be operational by the end of 2005.

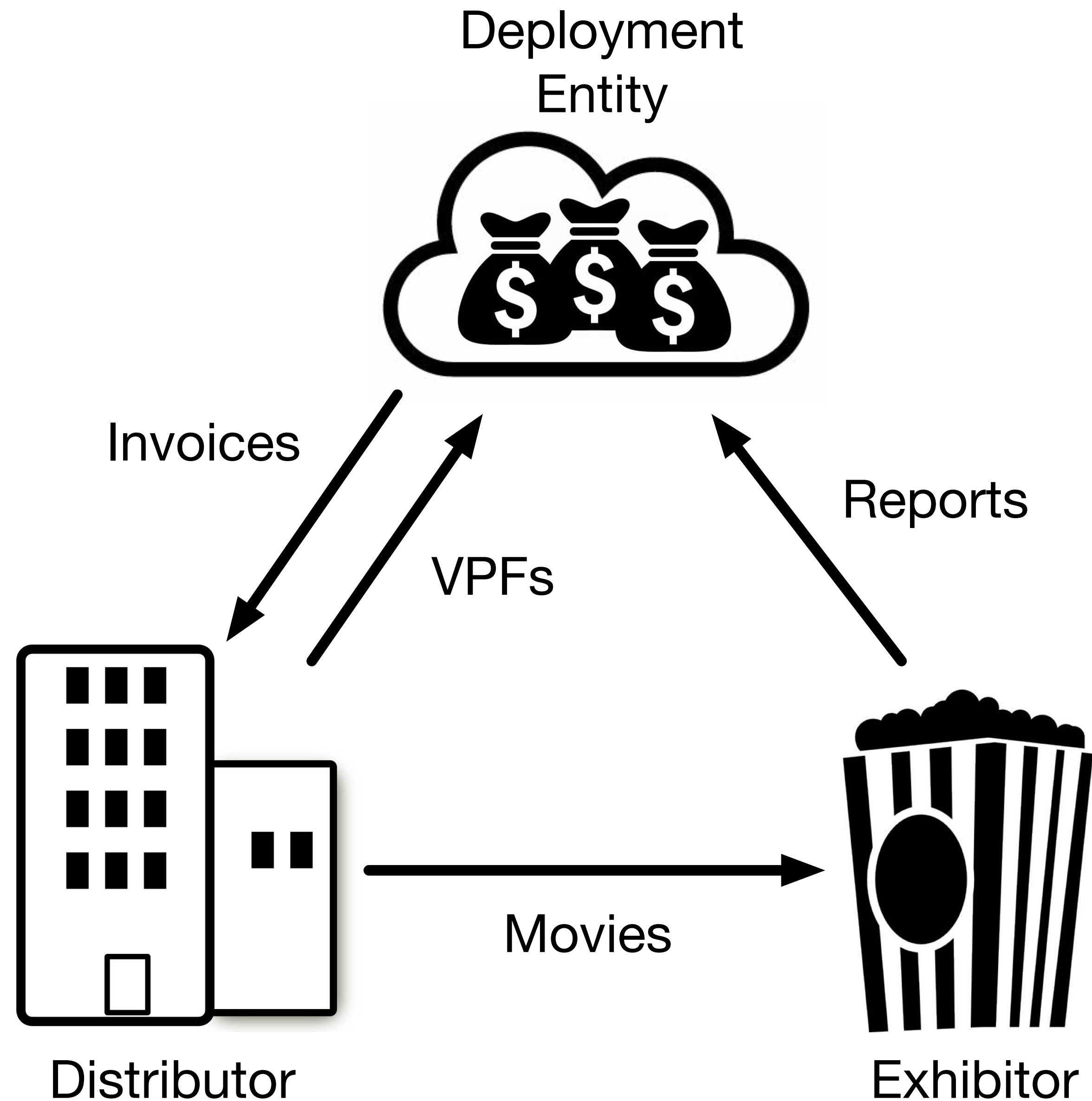
To facilitate the agreement, AccessIT has formed a subsidiary, Christie/AIX, to act as a funding vehicle and administrator. Under the terms of the agreement, the new entity will provide funding for a turnkey Digital Cinema solution that includes the latest generation 2K resolution Digital Cinema projectors and all related hardware systems. AccessIT and interested third-party lenders will provide capital for the systems. Christie/AIX will serve as intermediary between content owners – including major studios and independent distributors, who will pay "virtual print fees" – and exhibitors, who will be responsible for installation costs, software license fees, and a 10-year maintenance contract, with a cost structure similar to conventional film maintenance. The company anticipates that when implemented, the current plan is expected to have a material impact on AccessIT's future financial performance, contributing to the company's reported revenues, EBITDA, and cashflow over the next-ten year period.

But Another Catalyst Was Needed

- ❑ The digital transition as originally proposed would only deliver a replacement technology, with no value creation for the exhibitor.
- ❑ The adoption rate of replacement technologies can be very slow. A slow adoption rate would force studios to distribute both film and digital prints for many years, which would have been costly.
- ❑ Coincidentally, digital 3D projection technology was also introduced in 2005. Audiences were willing to pay more for a 3D movie, making 3D the value adding element of the digital transition.
- ❑ As exhibitors installed 3D systems, they turned to studios for VPF financing. VPF deals required 100% conversion of screens, driving the adoption rate.

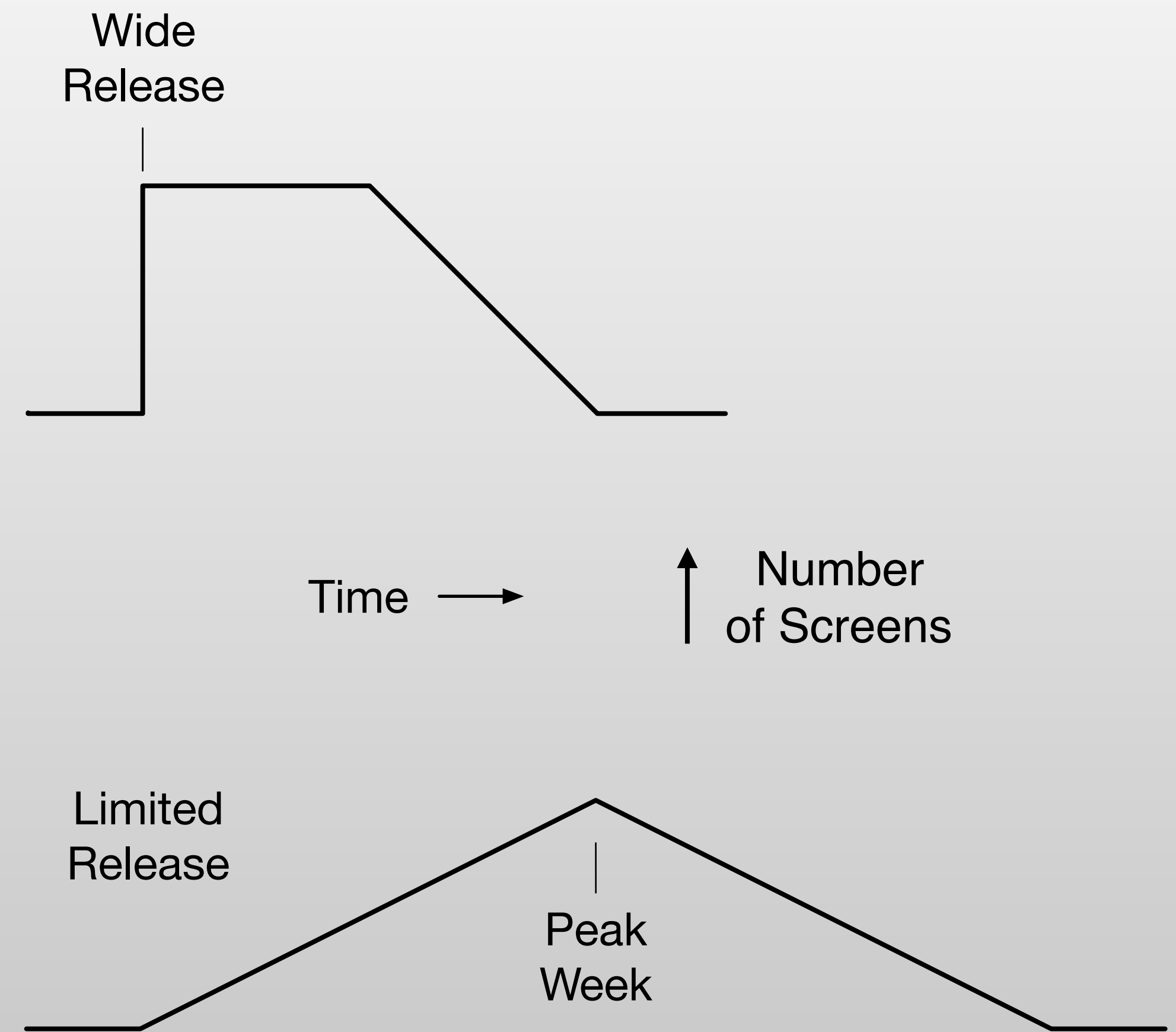
How the VPF Works

No Impact on the
Distributor-Exhibitor
Relationship
(true for US)



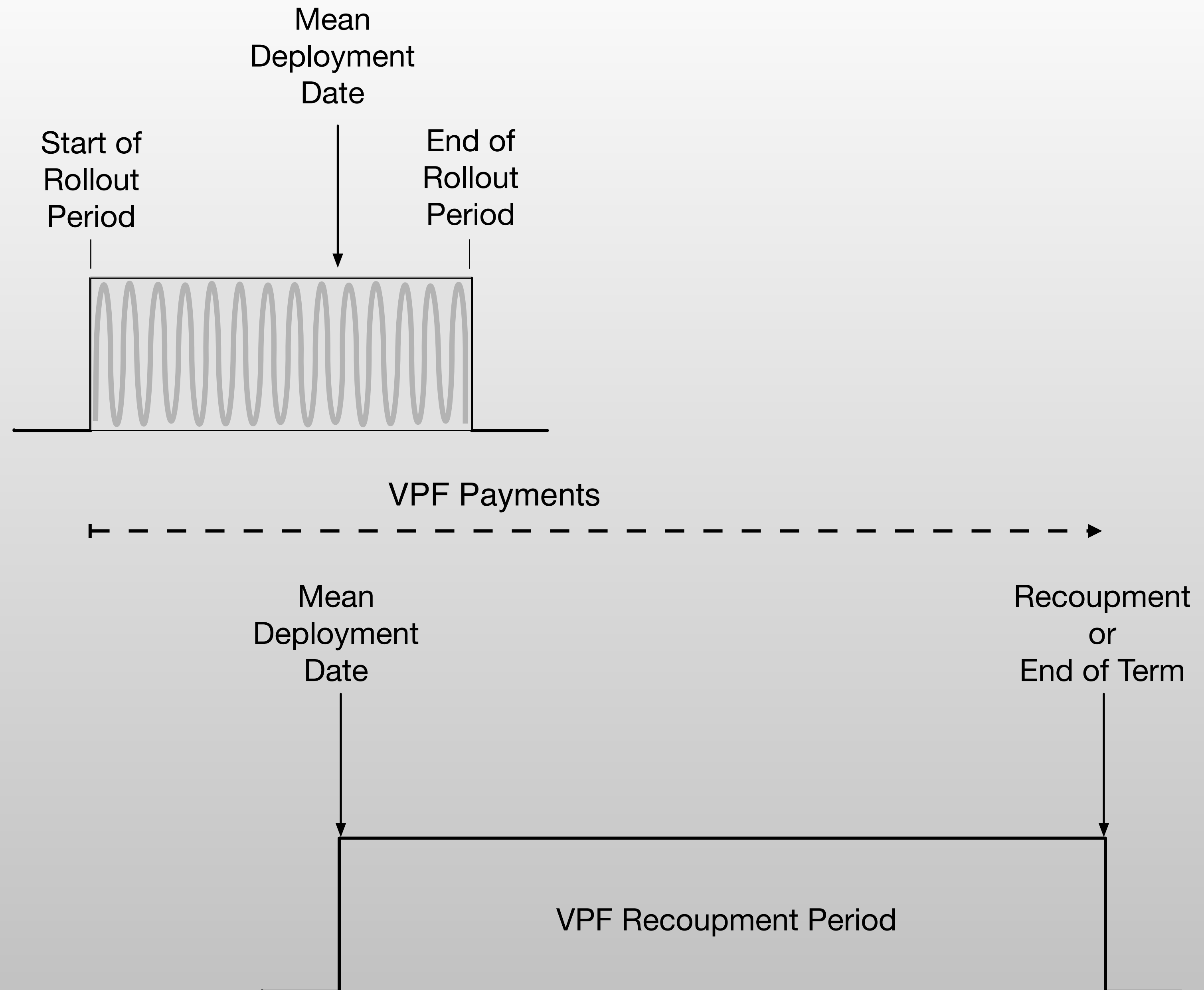
Structuring the VPF

- Designed to mimic film costs.
- VPF paid *per booking* for Wide Release. (< \$1000 per booking)
- *Per-screening* fees paid for Limited Release. (< \$50 per play)
- Fees generally adjusted per sliding scales to mimic film movement.



Payment Term

- Rollout Periods were typically 3 years.
- Fees terminate with Recoupment or End of Term, whichever comes first.
- Term Cap in typical US deal is 10 years after Mean Deployment Date.



Recoupment

$$\begin{aligned} & \text{Out-Of-Pocket System Costs} \\ & + \text{Finance Costs} \\ & + \text{Overhead} \\ & \hline & = \text{Recoupable Costs} \end{aligned}$$

Costs are Capped

No Two Deployment Agreements Are Identical

When One Studio Recoups, All Recoup

Equipment Cost Basis

- ▣ In US agreements, recoupable “Out-of-Pocket System Costs” are typically capped at 80% of actual. The cap may vary from studio to studio.
- ▣ Cost basis of acquired systems determined through depreciation. Depreciation rules may vary.
- ▣ Out-of-Pocket System Costs generally include:
 - ✓ Projector (including lamp, lens, base - DCI Compliant)
 - ✓ Digital Cinema Server (DCI Compliant)
 - ✓ Network and UPS Components
 - ✓ Extended Warranty
 - ✓ Transportation

Who Is Minding Recoupment in the US?

- DCIP: JV of AMC/Cinemark/Regal
- Cinedigm: formerly AccessIT

When Will VPFs Recoup or Term Out?

- Soon, if not already for early deals
- 2020 estimated at the outset

Who Has Title to the Equipment?

- Specified in Exhibitor Agreements (NOT Studios)

What Happens Next?

- ❑ DLP projector lifecycle is ~10 years. Projectors don't die...but become more costly to maintain.
- ❑ No VPFs for capex refresh.
- ❑ Financing for equipment refresh will be critical.
- ❑ Maintenance costs will severely limit the secondary market for old projectors.



Considerations for the Refresh Cycle

- ❑ Equipment sold during the refresh cycle will fall into two classes:
 - *Replacement*
 - *Value Addition*
- ❑ The replacement pitch will focus on lower total cost of ownership (TCO), shifting opex to capex, and long term maintenance. Note that exhibitor costs have not reduced with digital technology.
- ❑ The value-add approach should be end-to-end. Don't leave anything for chance. The digital transition's value-add scheme was last minute and lucky.
- ❑ New financing schemes could invite new business models, and could also drive a value-add model.

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