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

- First Virtual Print Fee agreements signed with Access IT (now Cinedigm) and Technicolor.
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.

- Coincidently, 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

Out-Of-Pocket System Costs
+ Finance Costs
+ Overhead

= Recoupable Costs

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.