

Large Format Cinema: Industry at a Crossroads

ANALYST INTERVIEW

September 10, 2001

The Industry ▶

The term "Large Format Cinema" generally refers to film-based entertainment distributed on film whose individual frames measure 15 perforations / 70 millimeters, 10/70, and 8/70.

This larger individual frame size—conventional motion picture film frames typically measure just 8 perforations by 35 millimeters—enables the projection of motion picture images onto screens measuring as large as 85 feet by 100 feet at a "throw" (distance from projector lens to screen) of up to 90 feet with full color saturation and image acuity.

Industry Profile ▶

Film Count: 107 (E)
Theater Count: 187 (E)

Large Format Theater Bookings: Top Four Films (1/98-4/01) ▶

Everest
(MacGillivray Freeman Films, Inc.)
Theater Bookings: 165 (E)

Mysteries of Egypt
(National Geographic Films
and Destination Cinema, Inc.)
Theater Bookings: 134 (E)

T-Rex: Back to the Cretaceous
(Imax Corporation)
Theater Bookings: 121 (E)

Dolphins
(MacGillivray Freeman Films, Inc.)
Theater Bookings: 85 (E)

Industry Organizations ▶

Large Format Cinema Association
www.lfca.org

Giant Screen Theater Association
www.giantscreentheater.com

Data source: *LF Examiner*.

During early September 2001, Kevin B. Skislock, senior entertainment analyst for Laguna Research Partners, was interviewed by James Hyder, editor and publisher of LF Examiner (www.cinergetics.com), a leading source of information and data for large format (LF) cinema industry professionals. James' interview with Kevin, published in LF Examiner's Giant Screen Theater Association convention issue, focused on the current state of the industry and the industry's prospects for future growth.

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LF Examiner ▶ Kevin, let's start with an overview of the LF cinema industry. What's your take on the current state of the industry?

Kevin B. Skislock ▶ Let's start with the positive.

First, the industry offers consumers an unparalleled movie-going experience. While conventional cinema exhibitors were hyping their flashy new megaplexes, LF veterans must have been scratching their heads wondering what all the hoopla was about. The big-screen, stadium-seating experience has been offered at LF venues for more than 30 years. And, to this day, the cinema industry offers nothing as immersive—both visually and aurally—as the LF movie-going experience.

Second, the LF industry's talent pool—from the standpoint of creativity, originality, and vision—is far superior, in my view, to that in Hollywood.

AFX ▶ ...and on the negative side of the ledger?

Kevin ▶ In my view, there are three key challenges facing the industry today. The first is the search for a sustainable business model at the equipment manufacturer level. The second concerns the emergence of digital cinema. And the third concerns the evolution of LF content.

AFX ▶ Let's start with the equipment manufacturer business model issue. This relates to a lot of major industry players like Imax [www.imax.com], Iwerks [www.iwerks.com] and MegaSystems [www.megasystem.com]...

Kevin ▶ Sure. There's a simple rule that anyone can use to evaluate the "sustainability" of any business model in any industry. The rule is, "Does a given business model provide compelling benefits to *both* sides of the transaction?" If it does, it's likely to be a winner over both the short run and the long run. If it doesn't, it might appear to be successful for a limited period of time. But in the long run, it won't be sustainable.

What will the winning business model in the equipment manufacturer space look like? I don't think that there's a single right answer to that question. I expect that we'll see more than one successful formula. But you can bet that all of the equipment manufacturer business models that prove to have long-term sustainability will have one thing in common. They will all provide compelling benefits to *both* sides of the transaction.

AFX ▶ How about Imax? What impact will the company's current problems have on the LF industry?

Kevin ▶ Well, the company is going through a pretty challenging time. Second quarter revenue was down 38% to about US\$38 million. Breaking the revenue number down, their system revenue fell by about 40%. The company installed, I think, just three systems in the second quarter this year compared with seven in last year's second quarter. Their revenue from the sale of digital projection systems slid about 48% to something like \$6 million. And film revenue dropped something like 26%. Not a very pretty picture.

But none of this is particularly unique to Imax. Other equipment manufacturers like Iwerks and MegaSystems have also been facing tough times.

Looking forward, I think that things will continue to be tough for the industry's equipment manufacturers. The commercial market for equipment has little sales visibility right now, in my opinion. As for the institutional market, how many untapped sites are there worldwide? The average new institutional site is probably smaller than in the past and average revenue per system to the manufacturer is likely, I think, to decline because these smaller venues will purchase smaller equipment packages. And will museums that now have LF film projectors replace them with digital projectors a few years down the road? Why should they? Their existing projectors are working just fine.

AFX ▶ What do you think a continued shakeout at the equipment level means for theater operators? They need to have their equipment serviced...

Kevin ▶ Well, I wouldn't be surprised at all to see a very healthy little cottage industry develop that is focused entirely on servicing existing equipment. Service providers not having the overhead expenses associated with low-volume equipment manufacturing might actually generate a nice stream of cash: low fixed costs, a recurring stream of service contract revenue. And we all know that there are increasing numbers of former equipment manufacturer employees who just might have the know-how to launch such a cottage industry.

AFX ▶ How about your second point, the emergence of digital cinema?

Kevin ▶ I think that the emergence of digital technologies carries both pluses and minuses for the LF market. I expect, though, that the pluses will far outweigh the negatives.

One of the challenges that it will create is that “film format” will eventually become irrelevant because film itself is scripted for an eventual exit.

On the plus side, the emergence of digital technologies should bring a substantial reduction in LF image capture costs. Lower capture costs will hopefully result in an even greater portion of a given production’s budget showing up on the screen.

The emergence of digital will also yield improvements in the ease of LF production. One of the most commonly heard complaints about LF image capture equipment is that it’s too intrusive from both a size and noise standpoint. And takes are short because LF film magazines can only hold a maximum of eight minutes of film. Digital will eliminate all of these issues.

AFX ▶ So, what does all this mean for the industry?

Kevin ▶ I see the future of LF being content driven as opposed to equipment driven. I see the role of so-called industry leadership shifting away from the equipment manufacturers and towards the industry’s content producers. And, in my view, that’s a good thing. It brings the industry back to its very impressive roots. What an exciting time to be involved in LF.

When you think about it, this is pretty much the state of affairs in the conventional film industry. The feature film business is driven by the creative community, the studios. Not by the equipment manufacturers, not by the exhibitors. And innovation is driven by content producers. George Lucas is a great example. Look at what he’s doing with video capture, special effects, digital display. Why should the LF industry be any different?

AFX ▶ What’s your view on the future of commercial LF?

Kevin ▶ If the commercial market is to ever take off, I think it’s going to be because content will create demand for equipment. Not the other way around. The idea that the sale of equipment to commercial venues will somehow force the creation of a steady stream of commercially-oriented product just doesn’t make a lot of sense to me.

AFX ▶ And the third point you raised, LF content...

Kevin ▶ Yes. I think that the placement of LF theaters in commercial venues has distracted a lot of LF industry players from LF’s traditional role as an industry innovator. LF is all about breaking new ground rather than traveling deeply carved ruts in well-traveled roads. LF is all about bringing new experiences to audiences rather than numbing audiences with predictable formulaic product.

AFX ▶ Again, content is king...

Kevin ▶ I think so. Like I said, I think this industry is returning to being content driven. If industry players on the content side don’t fill the industry’s leadership vacuum, the industry is in trouble. Without an engaging sense of vision from content producers, I expect the industry to wander aimlessly and, eventually, fade from importance.

The LF industry needs its own George Lucas. Someone with the credibility, creativity and confidence to lead the charge into new LF frontiers. Whether we’re talking about feature films or LF, I think that that person is more likely to come from the UCLA film school [www.tft.ucla.edu] rather than from the executive suites of the industry’s metal benders.

AFX ▶ So what will it take, do you think, for the LF industry to emerge from this period of transition as an important force in the entertainment industry?

Kevin ► Most importantly, I think that the industry must stay true to its roots. And I'm not talking about the specifics like the giant screen and the ultra-raked seating. I'm talking about the LF industry as a fountainhead of positive change in the filmed entertainment business. I'm talking about the industry's pioneering spirit. The industry's drive to bring a revolution to filmed entertainment.

Do you remember the multi-screen presentations at Expo '67 in Montreal produced by Imax's eventual founders, Roman Kroitor and Graeme Ferguson? I do. Now that was exciting... an assault on the senses. Those presentations were tremendously impressive manifestations of this industry's founding spirit.

For a number of reasons, the LF industry has worked its way into a defensive posture. This is never good for *any* business. The industry is now in a reactive mode. The industry has to work its way back to a proactive position. Back to the position of agenda setter, rather than agenda follower.

So here we all sit, biting our nails, knees shaking, wondering if someone from Hollywood will bless us with an LF sequel to some successful feature film. That's not what LF is all about. LF's earliest efforts were end-runs *around* mainstream Hollywood. In fact, they were more than that. They were brilliant leaps *beyond* anything Hollywood was capable of at the time.

Don't be distracted by the fact that a few equipment manufacturers have placed a bunch of LF projectors in so-called commercial venues. Don't worry about mimicking Hollywood. Don't worry about competing with Hollywood. As a group, you all represent the most legitimate creative force in filmmaking today. Compete with yourselves. Make a better film this year than you made last year. Make a better film next year than you're making today. If you do this, the rest will come naturally. Demand for tickets will blossom. And demand for new theaters, in all kinds of venues, will blossom, too.

So, what will it take? It will be a matter of mindset. If today's impressive pool of LF talent can stay rooted in the industry's original mindset of innovation, many great things are yet to come.

LFX ► In your view, what's the most likely scenario?

Kevin ► My money is on the LF creative community. I think they'll rise to the occasion.

LFX ► So you see hope for the industry despite theater closings and declining LF stock prices?

Kevin ► I think it was Bob Marley who said, "You think it's the end, but it's just the beginning."

Bio ► James Hyder (jhyder@cinergetics.com)

LF Examiner is edited and published by James Hyder, formerly of the Smithsonian's National Air and Space Museum (NASM) (www.nasm.edu). James has more than 15 years experience in every aspect of the large format cinema industry.

During his stint as Theater Manager for the most popular Imax theater in the world, James learned the concerns of exhibitors. In his career before NASM, he worked hands-on in film and video production. At Air and Space he assisted in the production of several of the Museum's IMAX films, including the Oscar-nominated *Cosmic Voyage* (www.nasm.edu/nasm/pa/CV). And in his last position at the Smithsonian, James researched the large format cinema distribution business and reported on the viability of establishing a film distribution office for the Smithsonian.

Bio ► Kevin B. Skislock (skislock@LRPonline.net)

Kevin Skislock is founding partner and CEO of Laguna Research Partners LLC. He also serves as the Firm's senior entertainment analyst.

Kevin has more 27 years of experience as a Wall Street stock analyst. Nearly half of his career has been spent analyzing stocks for leading buy-side money managers including Citibank, N.A., a division of CitiGroup, and Wellington Management Company. On the sell-side of Wall Street, he has analyzed stocks for the institutional and retail investment clients of firms including a "research boutique" subsidiary of Paine Webber, Inc. and Dain Raucher Wessels, Inc.

Having served as a Director of Investment Research and Investment Strategy Committee member on the buy-side of Wall Street and a Director of Investment Research and Commitment Committee member on the sell-side, Kevin is respected for his insights regarding the effective development and execution of business models across all sectors of the economy. He often takes an active role in the creation and development of new business enterprises, serving as a Director or Advisory Board member.

Kevin has been recognized by *Institutional Investor* magazine in their "Best of the Buy-side" rating of Wall Street's buy-side analysts. He has appeared on *NBC Nightly News with Tom Brokaw*, *CNBC's Market Wrap*, *CNBC's Business Center* and *The Wall Street Journal Report*, and is quoted widely in the general and financial press. He holds a BS degree in Economics from Villanova University in Villanova, Pennsylvania. He earned his MBA at The University of Chicago.

Companies mentioned in this interview ►

Imax Corporation (IMAX-NASDAQ)

Iwerks Entertainment, Inc. (IWRK-OTCBB)

MegaSystems, Inc. (a Safeguard Scientifics, Inc. (SFE-NYSE) partnership company)

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