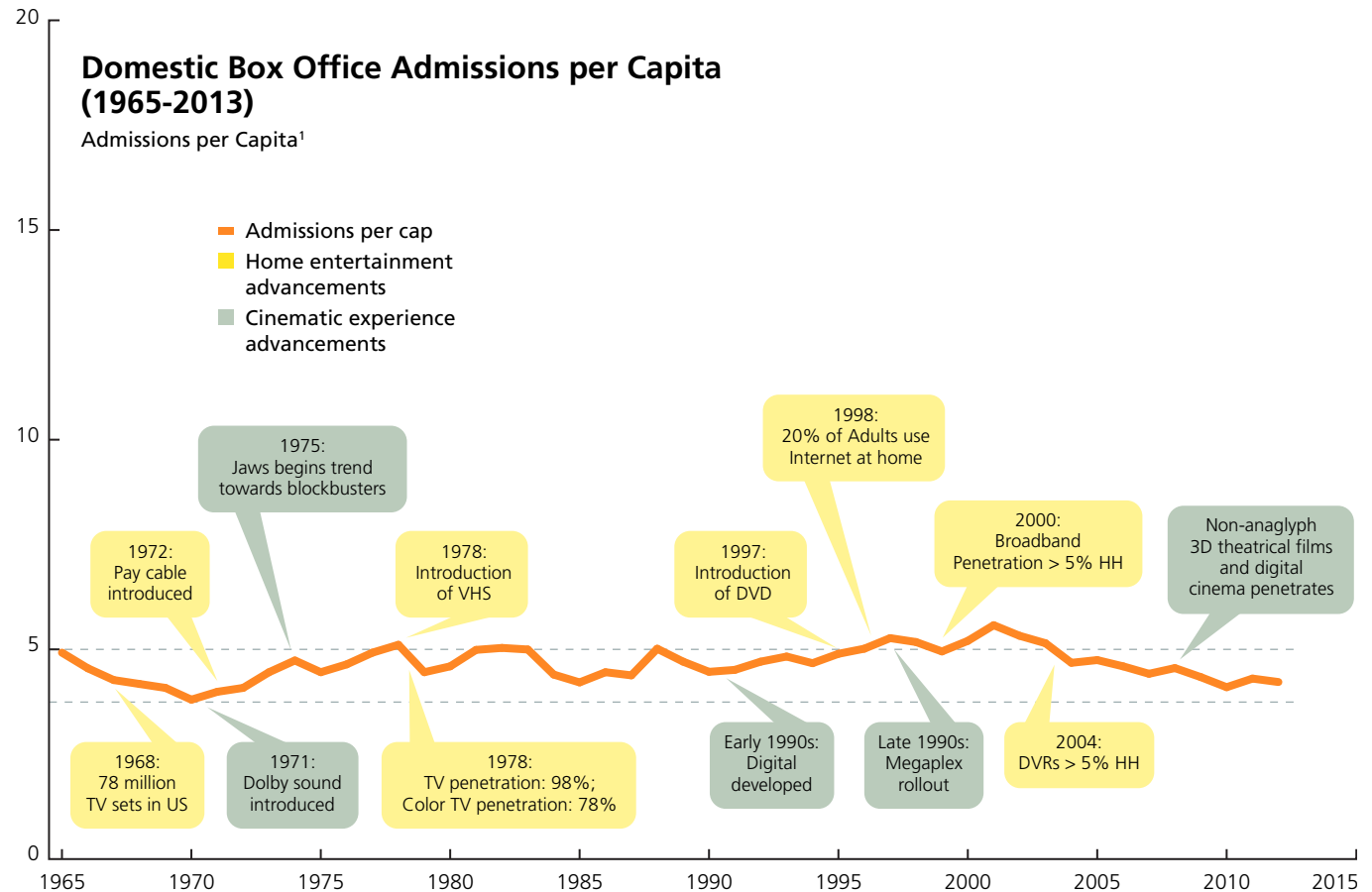


Video Killed The Radio Star: But It Hasn't Killed Movie-Going

With new innovations and choices in home entertainment over the past 50 years, you might guess that moviegoing is waning. However, despite the introduction of video in the 1970s, DVDs in the 1990s, growing broadband penetration and DVRs, Americans go to the movies about as often today – 4-5 times per year – as they did in 1965.

That's not to imply that the film industry is a steady business. While annual box office admissions have held between 4-5 for 50 years, a shift of even one movie admission per capita is significant. Box office admissions are currently on a downswing, having declined ~2.6% per year since 2002.



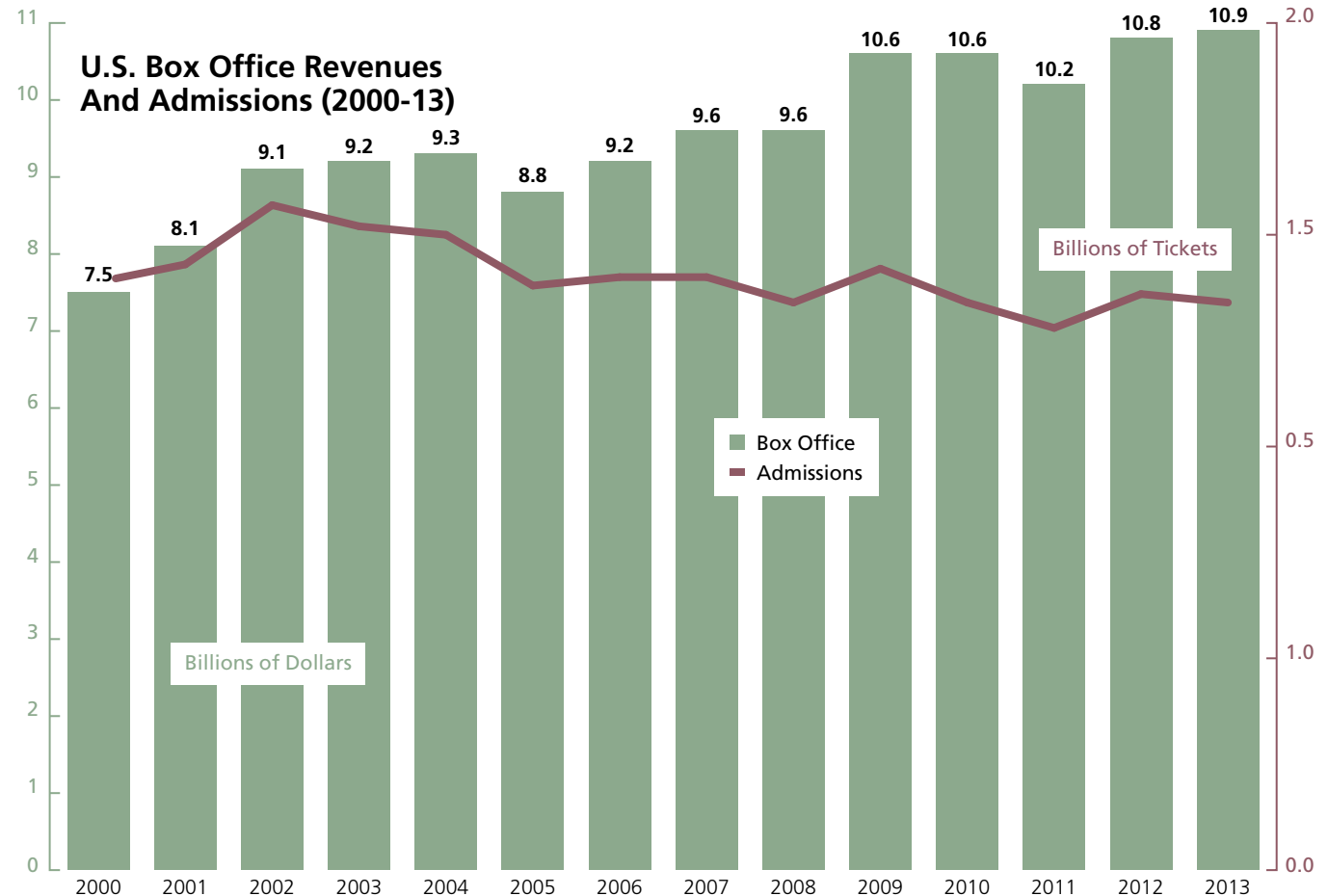
Note: ¹Per capita admissions calculated using entire U.S. population; MPAA-reported admissions per cap calculated using age 2+ U.S./Canada population
Source: NATO, Box Office Mojo, MPAA, National Academy of Engineering, L.E.K. analysis

How have box office revenues fared? >>

Up The Down Staircase: Movie Receipts Rise 20% – Movie-Going Falls 15%

North American ticket sales have dropped from 1.57 billion in 2002 to 1.34 billion in 2013, a cumulative decline of approximately 15% in just over a decade. (There's even a slight acceleration in annual decline in recent years.) But box office revenue has increased, rising from 2000-2009 and remaining stable from 2009-2013.

You probably know why box office is up – it's higher ticket prices. Some have attributed the admissions decline to increasing prices, but a 3% increase a year is in line with other products. So what is it?



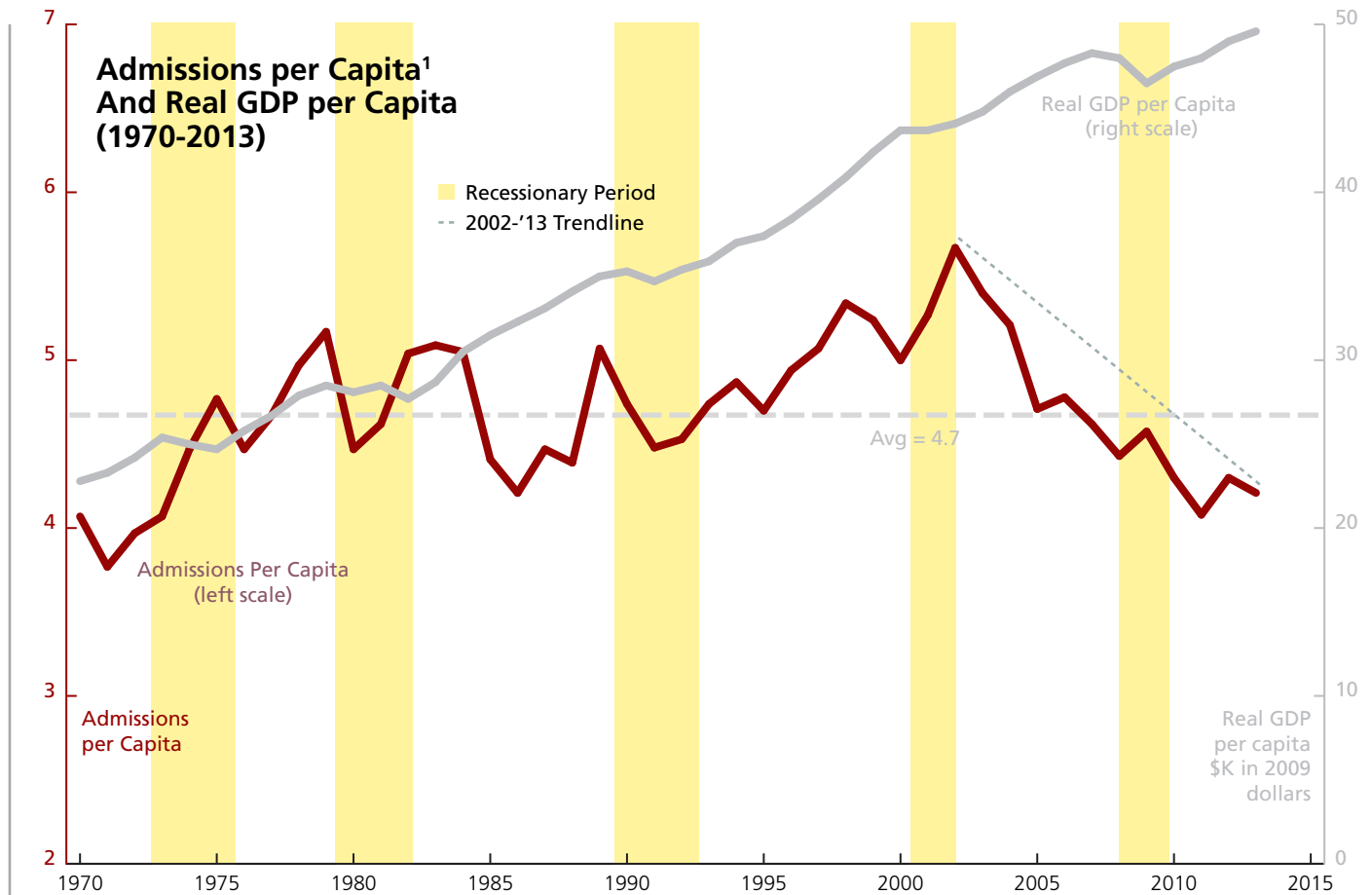
Source: Box Office Mojo, MPA, the-numbers.com, L.E.K. Analysis

How does the economy affect ticket sales? >>

Does A Recession Affect Ticket Sales? If You Film It, They Will Come

Despite recent declines in box office admissions, evidence shows that recessions don't really affect the cinema business. In this chart, the yellow bars call out the recessionary periods in the last 45 years. The gray line is the GDP per capita, showing a relatively steady increase of 1.8% per year since 1970. The erratic red bar shows the number of movies attended per person in North America, clearly indicating no correlation between admissions and GDP, or even admissions and recessions.

We all tighten our belts a little and watch our spending in tougher economic times. But if that alone is not the major factor impacting the recent decline, what is?



Note: ¹Per capita admissions calculated using entire U.S. population; MPAA-reported admissions per cap calculated using age 2+ U.S./Canada population
 Source: MPAA, Box Office Mojo, NATO, BEA, U.S. Census Bureau, L.E.K. analysis

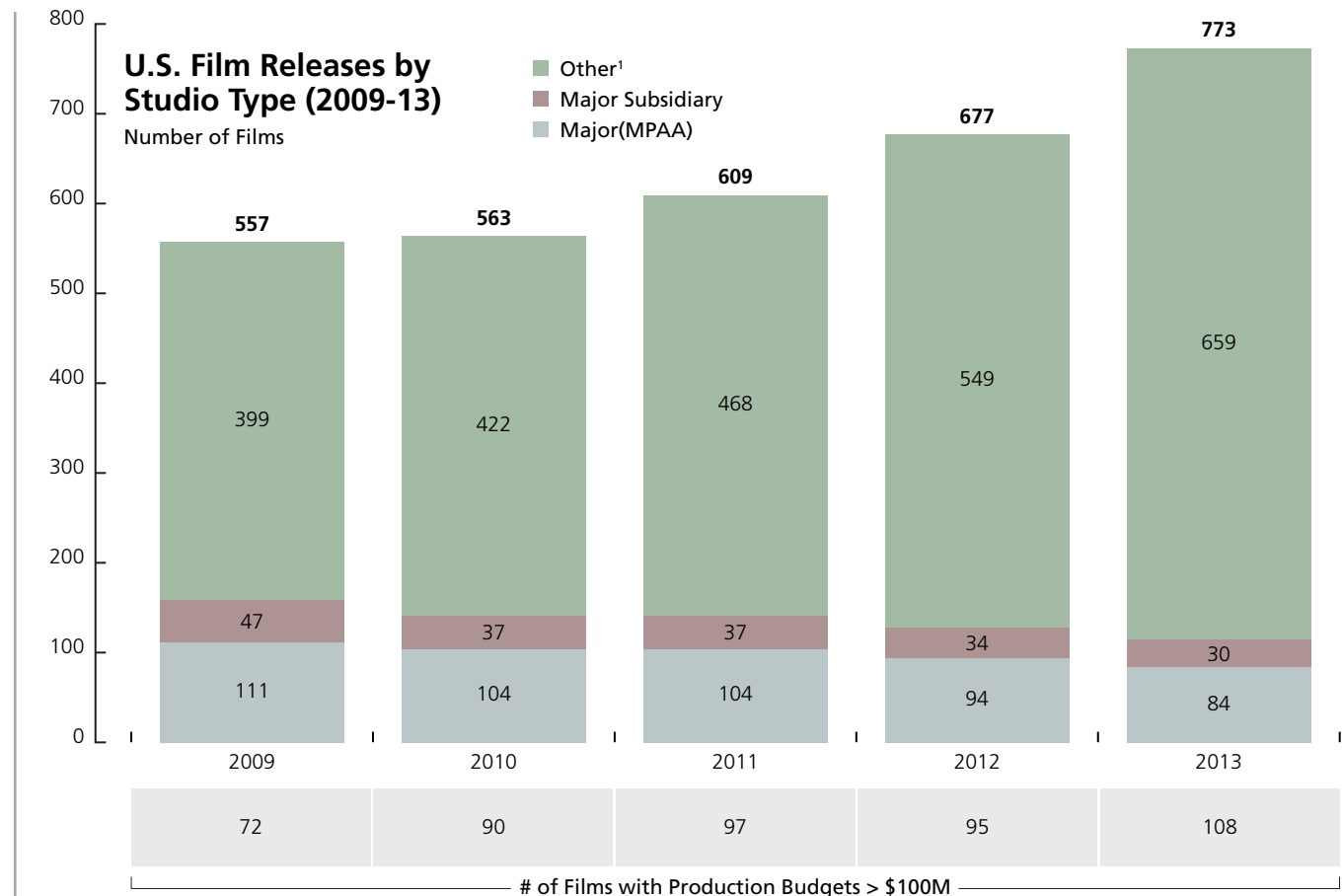
What other factors affect ticket sales? >>

It's A Mad, Mad, Mad, Mad, World: Despite Less Admissions, A Mad Increase In Movies and Movie Budgets

Movie production is up from 557 in 2009 to 773 in 2013 (8% growth per year). But major studio releases are down from 111 to 84, and all the growth came from independent and mini-major releases. The vast growth in non-major studio films did not replace the lack of major releases.

Note also that the studios spent far more per movie in this period. The number of movies with production budgets over \$100 million rose from 72 in 2009 to 108 in 2013.

The bottom line: Lifts in production budgets and the surge in independent films has not made up for the cuts in major studio releases.



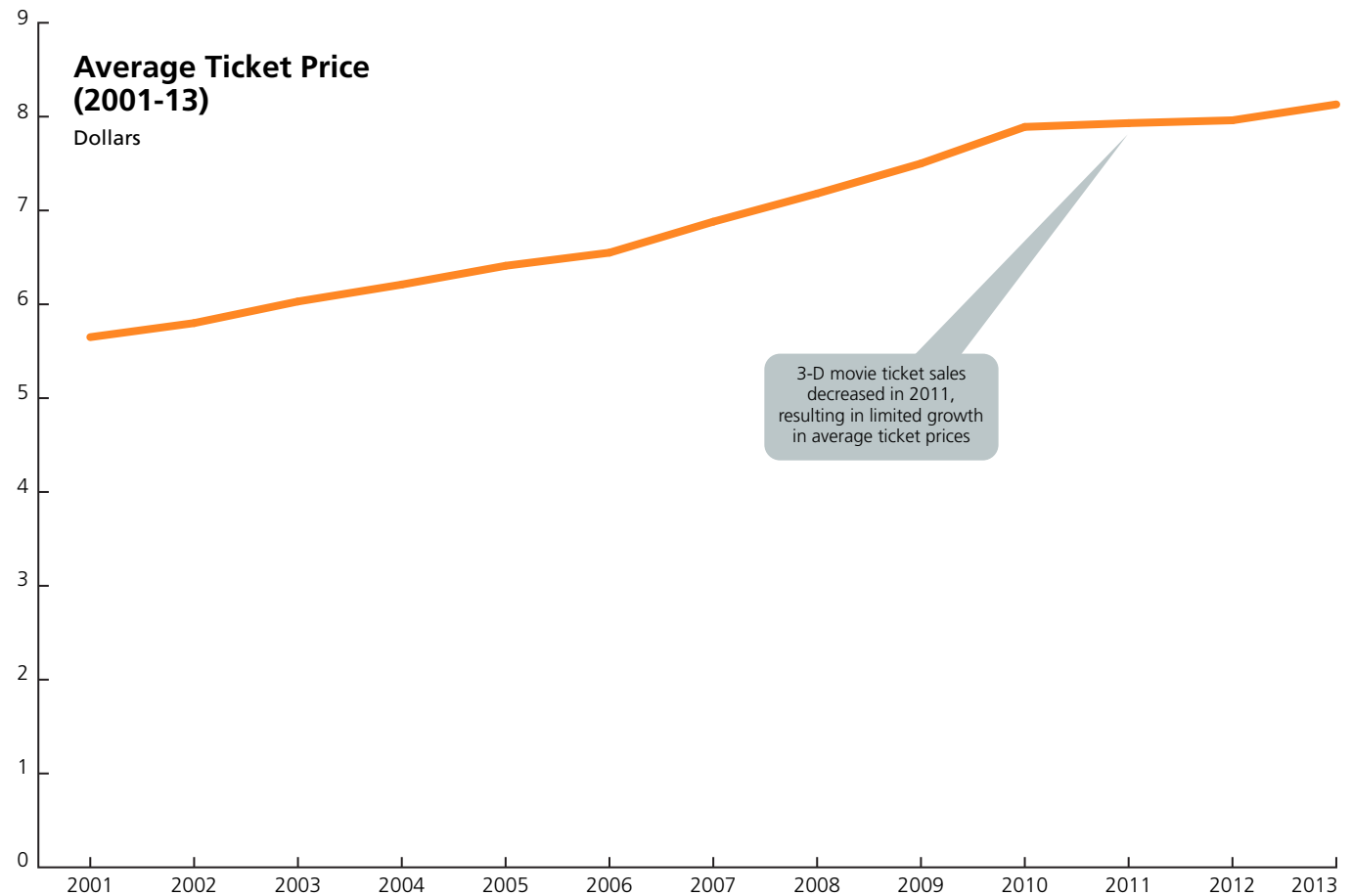
Note: ¹Includes independent and mini-major studios
Source: MPAA, the-numbers.com, IMDb, L.E.K. analysis

How have exhibitors counteracted the declining volume of their product? >>

A Star Is Born: Why Movie Ticket Prices Shot Up Between 2001 And 2009

Rising ticket prices have been a key factor in higher box office revenues, and 3D releases are an important contributor. At one point, 3D was heralded as the savior of movies at the box office. Recently, though, admissions have been declining and growth in ticket prices has tapered off over the last 3-4 years.

While there is no denying 3D has a significant impact on the industry, what exactly has this impact been and what does it look like going forward?



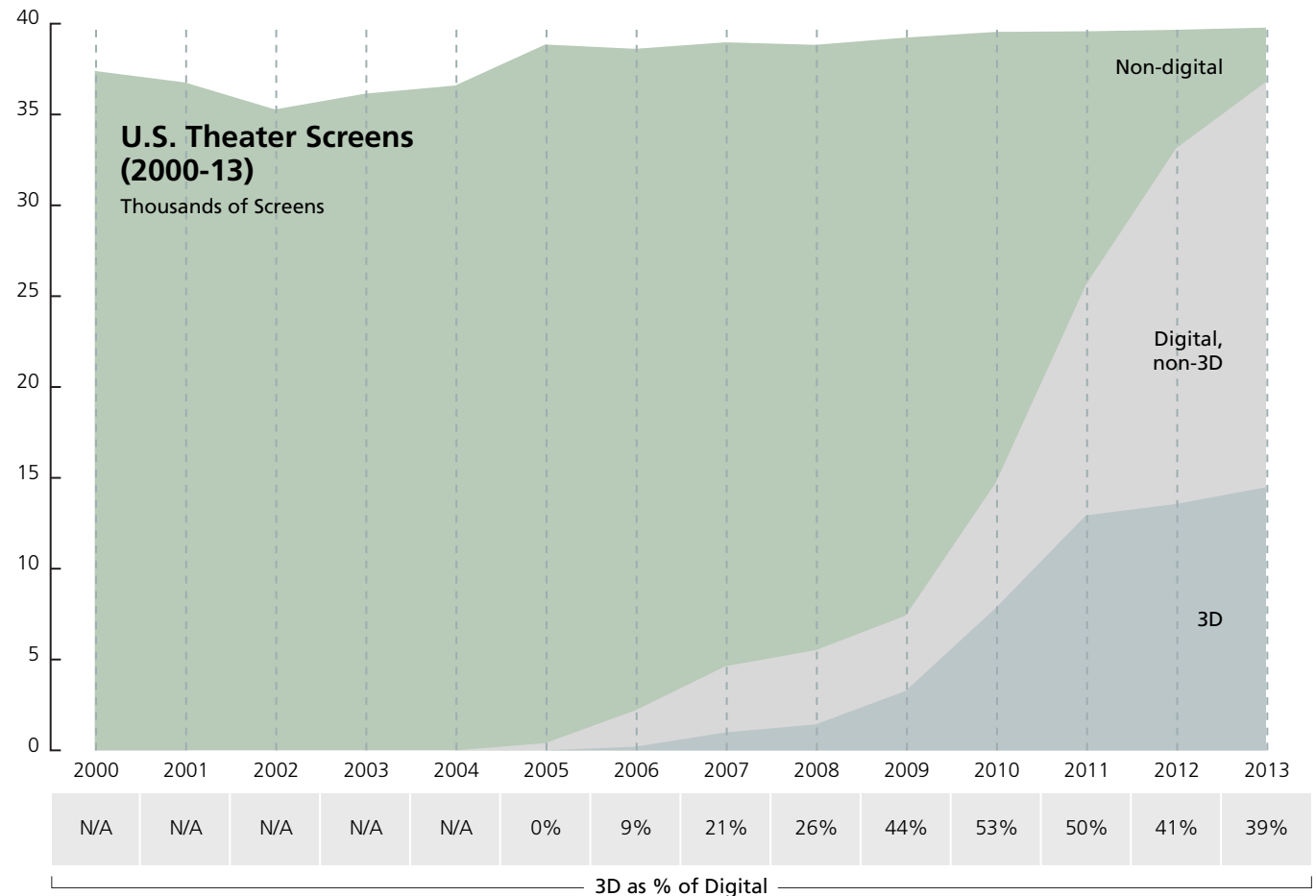
Note: ¹Forecast CAGR assumes growth consistent with years 2001 through 2013
Source: National Association of Theater Owners, Morgan Stanley, L.E.K. analysis

How has 3D affected the industry? >>

Houston, We've Got A Problem: The 3D Growth Run May Be At Or Near Its End

The increased availability of 3D movie releases helped drive movie ticket price increases, but the upside potential may be limited. In the five years prior to 2011, exhibitors added nearly 13,000 3D screens in anticipation of demand. Since 2011, exhibitors have only increased capacity by ~1,500 3D screens.

International markets may exhibit different dynamics, given some under-penetrated markets. For a full debrief, visit our series on international trends coming shortly.



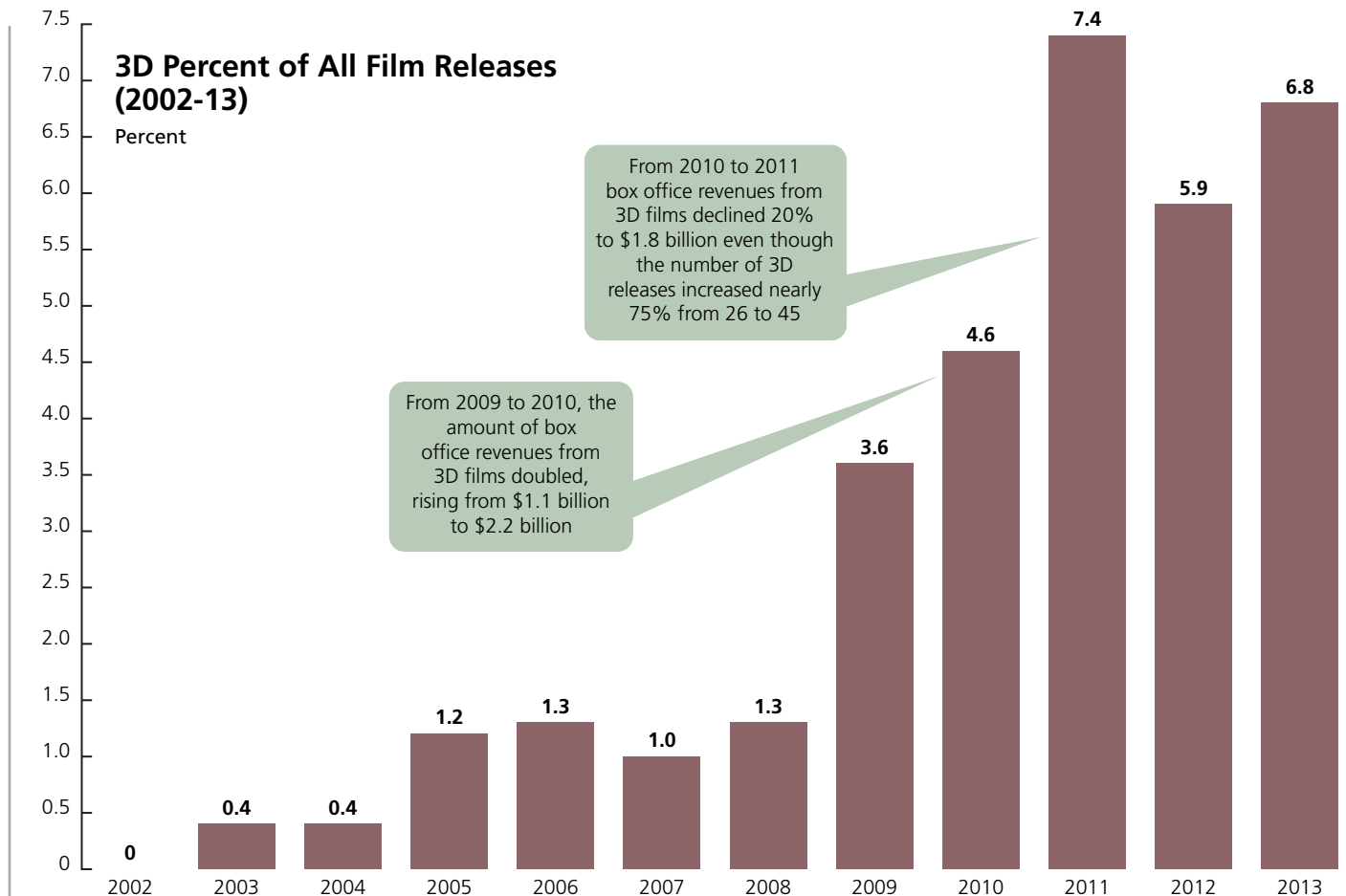
Source: MPAA, The Hollywood Insider, L.E.K. analysis

Where does 3D go from here? >>

Ground Control To Major Tom: 3D Movie Production Skyrocketed, Then Faltered

Studios and producers ramped up production of 3D movies significantly in 2009-2010, reaching a peak in 2011 with 45 releases (7.4% of all film releases).

As you can see, 3D releases are down from 2011. What are consumers saying about the value of 3D and whether 3D will grow going forward?



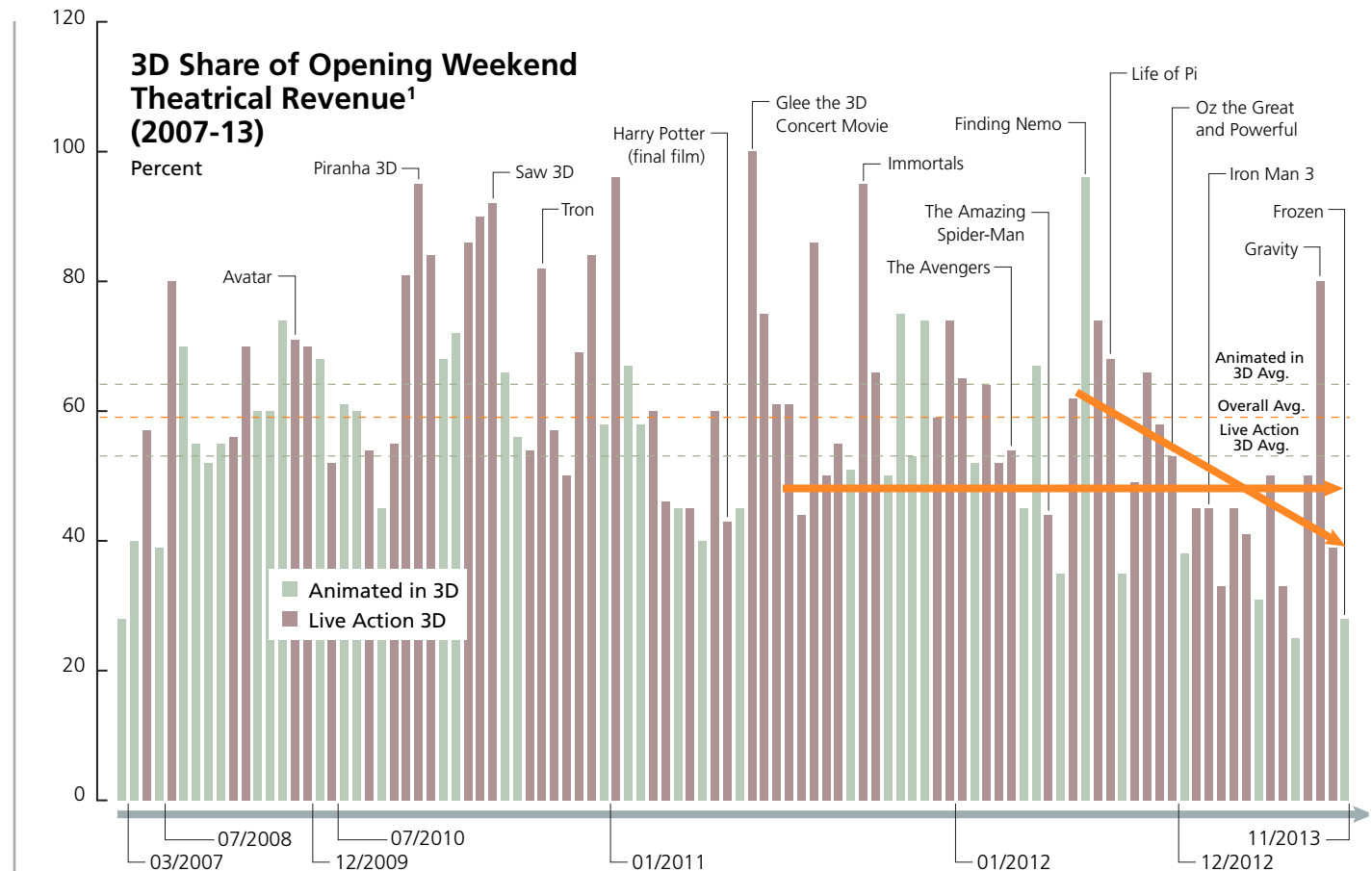
Source: MPAA, the-numbers.com, IMDB, PWC: Entertainment & Media, L.E.K. Research and Analysis

What's the value and growth potential of 3D? >>

Caught In A Celluloid Jam: 3D Is No Longer The Box Office Draw It Once Was

Studios' enthusiasm for 3D in 2009-2011 has since cooled. As illustrated in this chart, opening a movie in 3D used to be an enticing proposition for audiences as approximately 60% of opening weekend (when opened in 2D and 3D) was 3D; that figure has recently ebbed to a more temperate ~30%.

Many in the industry believe 3D is here to stay but has likely achieved or is near achieving its steady state. 3D was a much needed infusion to the industry...what's next?



What's next for the movie industry? >>

Our Outlook: Back To The Future?

In summary to our series of posts on box office trends where we discussed the decline in admissions, increasing ticket prices, and the leveling off of 3D's impact, we ask: what's next for the movie business?

While it is impossible to forecast outcomes with certainty, it is likely that exhibitors will continue to face pressures that will require a break from the norm. In addition, studios will find that recent successes in franchise management may cause an uptick in acquisitions of mass-appeal franchises.

Our takeaway: while studios can prosper with more special effects, exhibitors will need new ideas.

EXHIBITORS

- Continued pressure from declining traffic and flat box office
- Decreasing benefit from 3D
- Increased focus on driving dollars per visit (e.g. dynamic pricing, premium features and benefits)
- Subscription pricing a future game changer?



Source: L.E.K. analysis

STUDIOS

- Continued focus on tentpole releases with established fan bases
- Continued acquisition of libraries and franchises as studios seek next big thing
- Action/adventure, horror/thriller and animated titles are studio favorites
- Increased gigantism in movie selection, more special effects and fewer releases

