INSTANT INSIGHT

THE BIGGER (MOTION) PICTURE:

WHY IT'S NOT ALL DOOM AND GLOOM FOR THE CINEMA INDUSTRY

24th August 2022

Whilst much of the economy has made vast strides back towards pre-pandemic operations, the cinema industry on the surface remains somewhat unrecognisable when compared with its former self. However, look beyond news of empty screens, potential bankruptcies, and low admissions, and the reality is brighter, much brighter. In this brief insight report, Cushman & Wakefield takes stock of the current market conditions that threaten the industry and highlights some of the many opportunities that are likely to shape its future.

KEY FINDINGS

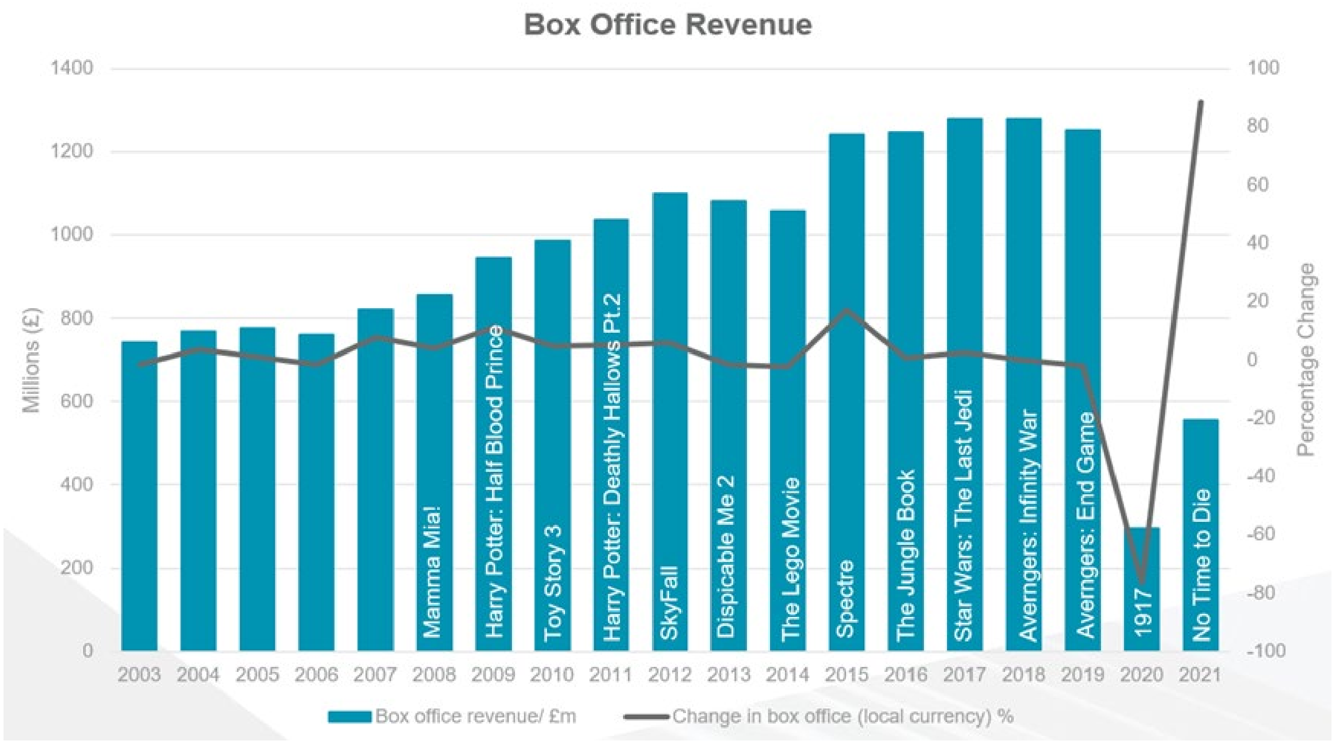
- The cinema industry is supported by a **massive demand for film**, and the experience of watching films from an auditorium in a **premium seat**.
- Operationally a number of the sector's **"big players" are struggling**. The expansion of major operators, and Covid-19 pandemic, has come at a cost and resulted in the accumulation of significant debt. However, a **clear path to recovery** and several potential solutions exist.
- Blockbusters are performing at **titanic levels**, and a strong schedule of releases aided by seasonal demand is likely to **propel the sector back towards pre-pandemic trading levels**.
- **A drive to quality is growing the luxury market**, which shows strong potential to elevate revenues beyond that of the core market.

CURRENT MARKET CONDITIONS

From 2012 to 2019, an average of 170 million visits were made annually by Britons heading to the cinema, equating to approximately 14 million visits nationally each month. Since the "re-opening" and removal of remaining Covid-19 measures, that figure has fallen to less than 10 million visits a month. Look further to average operating occupancies, and these have fallen from an estimated 25% to 15% in the same time period.

Although it may seem far too obvious to state that the Covid-19 pandemic dealt a damaging blow to the sector, it is important to note many of these challenges were already in play prior to the pandemic with ERV's having been under pressure for a number of years.

Figure 1. UK box office revenue, growth, and highest grossing production this year



Source: Cinema Advertising Association, 2022

The industry got off to a strong start in 2020 with January and February's admissions surpassing 2019 by 20% & 18% respectively. 2020 was anticipated to be a strong year for the sector, with high expectations that No Time to Die would add to the strong attendances of 1917. This, of course, was short lived as public concern led to subdued demand in March before the abrupt enforcement of a national lockdown.

Despite the renewed optimism brought on by a busy start to 2020, box office revenue growth had been low for some years, as shown by figure 1. Revenues had contracted during both 2013 and 2014, before seeing a resurgence in 2015 aided by 007 and the release of Sam Mendes' Spectre. Following an uplift in revenue and admissions, 2018 and 2019 also saw marginal contractions in box office revenues. Understandably, stagnant box office revenues reflect a similar trend to the number of admissions, which saw growth in both 2015 (9%) and 2018 (4%) but have otherwise remained relatively stable.

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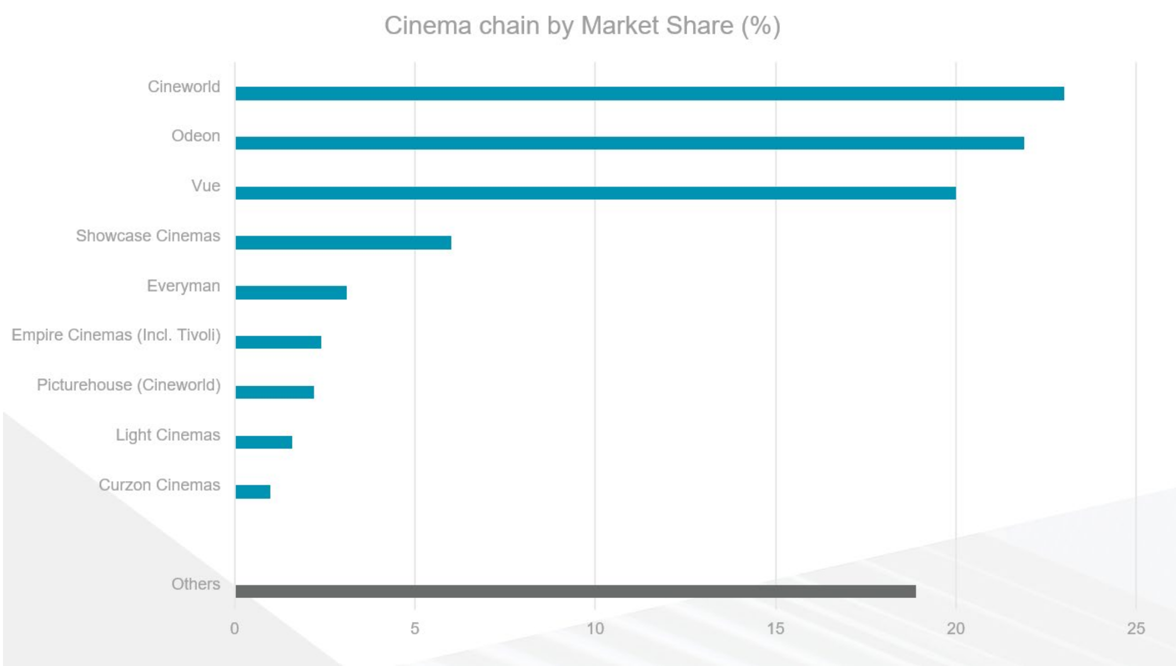
CHALLENGES

The cinema operating model has functioned almost identically since its commercial adoption in the 1920's, with income from admissions being supplemented by food and beverage sales and advertising fees. Prior to the pandemic, the sector had been subject to the erosion of USP's and fierce price competition between major operators. More recently the boom of the interactive experience market has threatened to erode revenues. The enforced closure of cinemas globally has resulted in the accumulation of considerable debts within the sector, and has bought a period of re-structuring for major operators such as Vue, who recently announced it was undertaking a debt-for-equity swap with its lenders, and Cineworld who recently announced a potential bankruptcy filing.

Product differentiation | The cinema industry has a three-firm concentration ratio of circa 70%. The remaining share of the market is saturated by a range of operators, with multiple flourishing sub-sectors. Within the range of offerings, differentiation between the major operators is minimal. Instead, strategic location selection and first-mover advantage play an integral role in attracting audiences and ensuring minimum occupancy requirements can be satisfied. Figure 2 shows indicative composition of the cinema market by operator. Whilst a considerable proportion is attributed to major operators such as Cineworld, Odeon, and Vue, further afield from the large multiplex model, the remaining market share is fought for by innovative brands disrupting the traditional offerings of blockbusters, popcorn and Tango Ice Blasts.

Figure 2. Pre-pandemic UK Cinema indicative market share by operator



Source: British Film Institute, 2019

CHALLENGES CONTD.

Extrinsic product | The sector is unique when compared to many other consumer sectors, as operators have almost zero control over the product it sells and exhibits. Supply of new films has also remained low since production was halted at the height of the pandemic. Considerable supply bottlenecks, postponement, and delays remain a key issue. Furthermore, the proliferation of subscription streaming services such as Netflix, and the rapidly growing Disney+, has also intensified competition for exclusive broadcasting rights resulting in increases in film rental tariffs and removing some medium budget productions from the market for cinema operators.

Rising Costs | Although the primary costs for screening films are relatively straightforward, high operating costs are widespread and are increasing almost universally. Staffing and heating and cooling costs typically form the most significant proportion of fixed costs which are under pressure due to both the cost-of-living crisis and labour shortages. In addition to labour, significant uplifts in the cost of energy, sanitation products, and food and beverages have also resulted in additional pressures for operators.

Cost of Living | Although the cinema industry has a strong value proposition within the wider spectrum for leisure activities, it is likely that an impact will be seen on admissions as we head into the winter months. The likely result: an increase in use of discounting and coupons, whilst a reduction in average food and beverage spend per head.

OPPORTUNITIES

Despite the seemingly gloomy outlook, the cinema industry plays a critical role within entertainment and remains a strong value proposition for viewers compared to leisure alternatives (dining, bowling, sport etc.). The industry is supported by a massive demand for film, and the experience of watching films from the auditorium remains largely unattainable at home even for those that have spent thousands on trying to replicate it during the pandemic. The outlook for 2022 remains positive with high value productions such as Avatar, Black Panther and Don't worry Darling amongst many others set to attract large viewership. This builds on the success of Top Gun: Maverick which, to date, has grossed over $1 billion globally (Box Office Mojo, August 2022), making it one of the most successful releases in modern cinema.

OPPORTUNITIES CONTD.

Product Differentiation | Innovative and diverse offerings are already proving a success, with concepts such as The Secret Cinema re-capturing audience's enthusiasm for classics such as Dirty Dancing, Casino Royale, and franchises such as Stranger Things. During July 2022, Secret Cinema ranked 10th in the UK Box Office figures, grossing over £2m with its Dirty Dancing interactive concept. Boutique cinemas that offer unique dining experiences, and a wider selection than the traditional food and beverage offering are also growing rapidly and are likely to lead to changes to the F&B currently on offer from the sector's major operators. The success of the revival and alternative categories also provides an opportunity, as collaboration between other performing arts and a healthy independent market strengthen the breadth of product and offer lower-cost options to operators.

Drive to Quality | Whilst major operators have made strides to diversify the viewing experience through a range of technologies and lounge experiences, a number of operators are also targeting more affluent locations. These locations provide greater potential for F&B income, and the ability to premium price. The Everyman Cinema group has successfully expanded to 38 sites across the United Kingdom, offering a first-class F&B offering, and employing a wider range of seating options, and table/in-seat service. A drive to quality is already tangible, with many operators now launching luxury and exclusive product lines. A strong example of this strategy can be found in Empire Cinema group which, through its Tivoli brand, operates in some of the UK's most prestigious locations. This shift is likely to open untapped corners of the market and unlock greater potential to increase average spend.

Leisure Resilience | Somewhat counter-intuitively, recent economic downturns and falls in consumer confidence have yet to be followed by large falls in leisure spending. Whilst discretionary spending is already impacted, the proportion of which that impacts the leisure sector is likely to be smaller than other spending categories. Decreases in non-essential journeys are also likely to affect cinema operators, less so than its peers, given that the vast majority of sites are strategically located within leisure clusters and top shopping destinations.

Robust Demand | From a real estate perspective, cinemas occupy relatively unique spaces, leasing warm assets with high ceiling heights in high footfall locations. As well as the opportunity for new entrants to acquire space at a reduced cost, the recent growth within the immersive event and activity sector has seen new occupiers seeking this space. These occupiers range from escape rooms, to indoor climbing walls, to micro-breweries and skydiving. Cushman and Wakefield is working with a number of events and experience occupiers seeking large ceiling heights of 8 metres and above, across the UK's major cities. A fall in operating occupancies may also signal a good time to reposition some of this spare capacity and strengthen the appeal of the sites' wider locations, a positive for landlords.

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"Although the current climate may seem overwhelmingly negative for the sector, the Cinema industry remains a key occupier supported by robust fundamentals, and healthy competition. Most assets within the cinema space are well located and characteristically strong, meaning the impact on real estate may be more muted than as felt by the public through changes to operating models."

~ Matt Ashman, Head of London Leisure & Restaurants

SUMMARY

From a real estate perspective, recent news of Cineworld's potential bankruptcy will cause concern, as they are a major occupier within the Shopping Centre and Leisure Park sectors. Difficulties in forecasting viewership and box office revenues, and economic headwinds, are likely to aid further caution. However, this temporary instability is not new for the sector with major bankruptcies and restructuring occurring across other major occupier types over recent years (Debenhams, House of Fraser, Ask, Pizza Express, Vue).

The sector benefits from relative strength, as a whole. It is set to recoup momentum from upcoming big releases as we approach 2023, and will gain additional seasonal demand as the evenings become darker. Although Cineworld accounts for approximately 23% of the total market in the UK, healthy and innovative brands, some of which have already restructured, are fighting for the remainder of the sector. There are likely to be operational shifts within the industry that look to further manage minimum occupancy thresholds and may result in repositioning of some space and deployment of new technologies. Should a CVA for Cineworld result in the closure of sites, the unique nature of the spaces occupied by Cineworld will benefit from demand from a diverse range of occupiers, including alternative cinema operators. Resulting in the natural question: considering the above, is a cinema still the best use for the space?

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CUSHMAN & WAKEFIELD RETAIL & LEISURE TEAM

Our team comprises a group of passionate specialists with expertise across the retail, leisure and F&B market. We complete over 500 transactions a year for prime landlords and occupiers, meaning we are well placed to provide transaction support and strategic advice.

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