

## **IMAX - Q3 2016 IMAX Corp Earnings Call**

OCTOBER 20, 2016 8:30PM ET

OVERVIEW: Co. reported 3Q16 revenues of \$86.6m and adjusted net profit of \$7.9m or \$0.12 per share.

### **C O R P O R A T E P A R T I C I P A N T S**

Jessica Kourakos IMAX Corporation - SVP of Global IR

Rich Gelfond IMAX Corporation - CEO

Greg Foster IMAX Corporation - Head of Entertainment

Patrick McClymont IMAX Corporation - CFO

### **C O N F E R E N C E C A L L P A R T I C I P A N T S**

Stan Meyers Piper Jaffray - Analyst

Steve Frankel Dougherty & Company - Analyst

Ben Mogil Stifel Nicolaus - Analyst

Alexia Quadrani JPMorgan - Analyst

Jim Goss Barrington Research Associates, Inc. - Analyst

Robert Peters Credit Suisse - Analyst

Aravinda Galappaththige Canaccord Genuity - Analyst

Darren Aftahi Roth Capital Partners - Analyst

Eric Wold B. Riley & Co. - Analyst

Eric Handler MKM Partners - Analyst

## **Operator**

Good day and welcome to the IMAX Corporation third-quarter 2016 conference call.

(Operator Instructions)

Today's conference is being recorded. At this time I would like to turn the conference over to Miss Jessica Kourakos, Senior Vice President of Global Investor Relations. Please go ahead Miss.

## **Jessica Kourakos - IMAX Corporation - SVP of Global IR**

Good morning and thanks for joining us on today's third-quarter 2016 earnings conference call. Joining me today in our New York office is our CEO, Rich Gelfond; our CFO, Patrick McClymont; and our Head of Entertainment, Greg Foster. We will each have prepared remarks and will be available for Q&A. Also joining us is Rob Lister, Chief Legal Officer and Head of Business Development.

Today's conference call is being webcast in its entirety on our website. A replay of the webcast will be made available shortly after the call. In addition the full text of our third-quarter release and the slide presentation accompanying today's call have been posted on the Investor Relations section of our website.

I am pleased to announce that we will now be providing quarter-to-date box office results on the IMAX Investor Relations website beginning next week. We expect to provide these updates every Friday with a one week lag. We have also created a new investor relations twitter account handle IMAX investors that will include this box office disclosure as well as other items that may be of interest to the investor community.

Finally, I would like to remind you of the following information regarding forward-looking statements. Our comments and answers to your questions on this call as well as the accompanying slide deck may include statements that are forward-looking and that may pertain to future results or outcomes. Actual future results or occurrences may differ materially from these forward-looking statements. Please refer to our SEC filings for more detailed discussion of some of the factors that could affect our future results and outcomes.

During today's call references may be made to certain non-GAAP financial measures as defined by Regulation G of the Securities and Exchange Commission. Discussion of Management's use of these measures and the definition of these measures as well as reconciliations to adjusted net income, adjusted EPS and adjusted EBITDA as defined by our credit facility are contained in this morning's press release. With that let me now turn the call over to Rich Gelfond.

## **Rich Gelfond - IMAX Corporation - CEO**

Thanks, Jess, and thank you all for joining us this morning. The third quarter served as another example of the strong demand for IMAX theaters that we have seen throughout 2016. In the third quarter alone, we signed agreements for 162 new IMAX theaters most notably our 150-theater deal with Wanda, which was the single largest deal in the company's 50-year history.

Year to date we have signed agreements for 293 new theaters which is by far the most we have signed in a single year let alone in a nine-month period. In addition to continued signing strength in China, we have executed a number of agreements with partners in Western Europe such as Kinopolis in Belgium, Cinemark in Denmark, UCI in Italy and just a couple of weeks ago we announced a five-theater deal with Pathe which is their second deal with us this year and our largest agreement in France in our history.

In fact, I was in Europe last week where I met with Senior Management of several exhibitors and I was very encouraged by IMAX's position in that market. Overall I think there is a robust opportunity for us in Europe. The market tends to have strong PSAs and recent consolidation such as AMC's acquisition of ODEON and UCI could lead to more activity in that market.

Given our record level of signings activity this year, our backlog has grown to an all-time high of 547 theaters at quarter end and is derived from exhibitors in 46 countries. This backlog provides us with an excellent visibility into future installs and when taken together with our exciting existing commercial network of roughly 1,050 theaters means that our footprint should grow to approximately 1,600 screens over the next few years. That is 50% larger than it stands today and doesn't include additional theaters that we will sign and install within that period of time.

Our increased level of signings activity over the past year is accomplish by heightened installation activity which as you know is a key driver of our growth. In the third quarter we installed 48 new theaters and now believe we will install between 155 and 160 new theaters for the year, which exceeds our pace of installations in recent years.

As we look to 2017, while still early, initial indications suggest that installation should be similar to 2016's level. All in all we are very pleased by our exhibitor partners' desire to not only add additional IMAX theaters, but to get them up and running as quickly as possible.

With regards to the expansion opportunities I mentioned earlier, we are continuing to make progress all over Asia. In addition to China countries such as Japan are very attractive given the overall opportunity in that market and the success of our partnership with Toho which follows our success with many other exhibitors including Tokyo.

Another market that I am excited about is the Middle East with its relative under penetration of IMAX screens, strong PSAs, and growing interest of exhibitors. As a matter of fact the number one IMAX theater in the world for Sully, Magnificent Seven and Deepwater Horizon with the [mole] of Emirates in Dubai which recently installed our laser projection system. Greg, why don't you now take a minute to walk us through the film side of the business.

## **Greg Foster - IMAX Corporation - Head of Entertainment**

Thanks Rich and good morning everyone. Starting with our third-quarter box office results, we generated a global box office of \$186 million in the quarter, resulting in a Q3 PSA of \$185,000. Geographically speaking domestic box office grew 12% to \$68 million primarily led by an 8% PSA growth.

International, ex China, and China markets generated PSAs of \$214,000 and \$171,000 respectively. It goes without saying that there is some natural variability tied to the box office which is beyond our control. However despite the challenging international box office environment in Q3, we had several markets outside of the US perform extremely well, including Latin America which saw PSA growth of 15% year over year. Latin America's growth was underpinned by strong performance from Mexico, Ecuador, and Brazil which saw PSA growth of 28%, 24%, and 12% respectively, which is encouraging given the opportunity we see in the region.

Looking at Mainland China in a bit more detail, our Q3 box office of \$52 million was down roughly 20% over last year. We believe there are a few principle reasons for the decline. First, the R&D has depreciated roughly 5% since Q3 of 2015. Therefore, on a constant currency basis, our Q3 box is down 15% and year to date is up 2%.

Another factor contributing to the decline is ticket prices. Our ticket prices similar to the overall industry in China are down 5% to 10% since the period a year ago. We believe the primary reason is related to discount pricing. Theatre operators tend to offer promotional pricing on newly opened theaters of which we have had many recently. And lastly there is a ramp-up period that takes place for newly opened theaters. Typically it takes a new theater about 24 months to hit full stride as the theater operator builds awareness and gets the marketing, ticketing pricing and everything else right.

All of these factors contributed to the weaker China box office. However, we remain bullish on the long-term outlook for China as we believe these factors are cyclical and will work themselves out over time as the film slate also continues to improve. Needless to say the second and third quarters of the year overall were sluggish in the box office. With that being said it is important to remember that the first five months of the year were very strong and came off of 12 or so months of record-setting box office in 2015.

More importantly box office momentum should begin to build steam once again in the fourth quarter with titles such as the Harry Potter spinoff *Fantastic Beasts and Where to Find Them*. The Marvel film studio film *Doctor Strange*, which by the way is premiering tonight at the TCL Chinese IMAX in Hollywood and the film *Doctor Strange* features 60 minutes of specially formatted footage for IMAX. And of course *Rogue One: A Star Wars Story*.

We also have some prominent titles playing abroad in the quarter such as Zhang Yimou's *the Great Wall* which is releasing in China in mid-December. These titles should provide us with solid momentum heading into the promising 2017 and 2018 film slates.

Furthermore we recently upped our studio deals with Fox and Warner Bros. These along with our existing slate deals with every other major studio provide us with strong visibility into our future slates which again are coming together quite nicely.

Focusing on 2017 for a moment, it is looking like there should be a major blockbuster virtually every month of the year. Even better, many of these films, in fact twice as many as last year will include IMAX DNA. Having been filmed with IMAX cameras and or utilizing our enhanced IMAX-specific aspect ratios. As many of you know, we tend to over index on films that are designed specifically for IMAX.

Looking at next year in more detail, there are some fantastic pillar titles and I would like to name a few. In February we will have the Lego Batman movie. In March, we have Disney's live action Beauty and the Beast. In April, we will see the next Fast and Furious installment, Fast 8. In May, we have the sequel to Guardians of the Galaxy.

In June, we have Wonder Woman and the next Transformers which will be prominently featured with IMAX cameras. In July, we will have Spiderman Homecoming and Christopher Nolan's new film Dunkirk, which is materially filmed with IMAX film cameras. And between November and December we have the Next Door, the first Justice League film and of course Star Wars Episode VIII. Clearly there is no shortage of IMAX-centric films next year and of course there will be additional titles added to what I just mentioned.

Beyond 2017, 2018 is also shaping up to be full of tentpole titles. We're still firming up parts of the calendar and have not confirmed all of the following titles I'm going to mention. However, you can expect to see another year of big blockbuster titles with big major releases which include: a Jurassic World sequel; a Predator sequel; Marvel's Black Panther; Alita Battle Angel, which is a Jim Cameron and Jon Landau production from Lightstorm Entertainment; Pac Rim 2; Ready Player One, the Steven Spielberg film; the next Avengers, Infinity Wars, which is being filmed entirely by the Russo brothers with IMAX cameras; a Star Wars, the Hans Solo spinoff; Toy Story 4; Warner Bros. DC's Aquaman; Fantastic Beasts 2; Mission Impossible 6; and the Avatar sequel to name a few.

Again, the anticipated strength of the film slate over the next 24 months coupled with our quickly expanding network should position us well to take advantage of the years ahead. With that I will pass the call back over to Rich.

**Rich Gelfond - IMAX Corporation - CEO**

Thanks, Greg. As we said box office cycles are short lived and we try to get not so caught up in the month-to-month or quarter-to-quarter variability that is inherent in our business. So rather than fixate on one metrics I think what is important is that we continue to focus on expanding the network, improving our technology, containing costs, and creating exciting experiences for our consumers. A pick-up in box office will come and based on what Greg just discussed it sounds like it should come sooner rather than later.

I would like now to briefly touch on a couple new initiatives outside of our core business and are particularly excited about and our key focuses of mine. One is the original content strategy and the other is virtual reality. Touching first on our content strategy, as I mentioned earlier, with a commercial network of over 1,050 theaters, an additional 550 theaters in backlog, we now have critical mass to leverage our distribution platform in more ways than we have done in the past.

You may recall that we established both the Documentary Film Fund and China Film Fund to invest in content and are currently exploring new opportunities and partnerships to invest in original content and facilitate its development and release. We view this strategy as being a natural evolution to our existing content strategy as this new content would help fill the gaps in our film slate and not disrupt existing windowing patterns.

We have had a lot of interest from filmmakers and a wide array of content creators to partner with us with the draw stemming for our limited release window availability, global reach and attractive target demographic. For new or less known franchise in particular having IMAX associated with your content can provide a boost. We are in discussions with a number of these content creators regarding the opportunity so stay tuned as I believe we will have more updates on this initiative in the relatively near future.

The second area of focus is VR, as [medieval] virtual reality. As many of you on this call know, IMAX is in a unique business with deep expertise across a number of disciplines. On the film side, we help capture and remaster content. We work with exhibitors to install theaters. We are technology, producer and integrator and at the heart of it all we have a tremendously valuable brand with global recognition.

The core requirements of launching a location-based VR experience line up nicely with our company's core skill sets. We have studio and film maker relationships on the content side; capture mechanisms for new content; relationships with exhibitors and real estate developers for potential VR sites; and a brand that is synonymous with immersive experiences.

Since we announced our VR strategy there has been strong interest for partnerships content deals and many other opportunities and unlike many other VR offerings out there, which are targeting the at-home experience, we're focused on the location-based offering which has the ability to provide a broader array of high quality more immersive content experiences with a social element out of the home. Our national plan is to open our first two pilot locations, one in LA and the other with ODEON in the UK, test the concept and assuming this concept works, embark on a more aggressive rollout schedule.

In terms of what the experience will look like, the IMAX VR centers will employ a new modular design proprietary to IMAX that will consist of several VR pods to allow multiple people to engage in the experience. So you can go with friends to enjoy the interactive exciting movable VR experiences. We expect our initial pilot locations in LA and the UK to open by year end.

With regard to economics, we plan to adopt a JV model similar in nature to our cinema business. While I don't want to get too far ahead of ourselves, we continue to be very excited about this initiative and look forward to sharing more about our business after we get our pilot sites up and running. I want to underline the word pilot is a test. We're not investing a lot of money at this time in the initiative. We are doing a test. If the test works we will go forward and I think it is a very exciting business for IMAX and I'm quite optimistic. But we're certainly not getting ahead of ourselves.

All in all the company is in a very exciting place. We are signing and installing theaters at a record pace which positions the core business to take advantage of robust film slates ahead and in addition to the core business we are in the late stages of launching some exciting new initiatives. With that said, let me turn the call over to our new Chief Financial Officer, Patrick McClymont. Patrick.

**Patrick McClymont - IMAX Corporation - CFO**

Thank you, Rich, and good morning everyone. It's a pleasure to participate in my first earnings call as CFO of IMAX. Before diving into the results, I thought it might be worthwhile to share some of my initial observations of the Company and a few of my areas of focus in the months ahead.

It goes without saying that IMAX holds very strong brand equity and generates compelling economics for our exhibitor and studio partners around the world. This is evidenced by the impressive network growth during the last several years and more importantly by the record number of theaters in backlog. Clearly the uptick in signings levels signals ongoing strong network growth for the foreseeable future. With continued growth as a backdrop, it's my goal to ensure the finance department works seamlessly with the various business units so that we can continue to grow quickly, efficiently, and of course profitably.

As IMAX invests in promising new areas of business, we will look to be disciplined as we optimize our use of capital, focus efforts around cost control, and operating leverage and ultimately maximize our returns. I believe there is tremendous opportunity to execute the expansion of the core business while also leveraging IMAX's brand equity for new areas of growth. I'm excited to be a part of this new chapter in IMAX's development.

With that, let me review some of the key results within our core business for the third quarter. The sustained momentum on the signings front has facilitated a healthy environment for IMAX theater installations. During the quarter, we installed a total of 48 new IMAX theaters, exceeding our Q3 guidance of 40 theaters and marking a record number of installs for the third quarter. As theater operators ramped up ahead of 2017's promising film slate.

On the new installations, 15 were sales-type arrangements, 24 were full JVs and nine were hybrid-JV arrangements. Additionally we had two laser upgrades in the quarter. As Rich mentioned we will likely end up installing between 155 and 160 new theaters this year. Of the roughly 63 new theaters expected to install in Q4, we anticipate approximately 17 to be sales-type arrangements, 35 to be full JVs and 11 to be hybrid JVs.

Moving onto our financial performance, our Q3 revenues were \$86.6 million which resulted in total gross profit of \$44.9 million, or 51.9% of revenues which is up from 49.8% from Q3 last year. Our JV and DMR revenues were \$19.7 million and \$21.5 million respectively and generated margins of 55.7% and 57.8% respectively.

For the JV business it's important to note that our margins were diluted slightly by the large number of installations completed in the quarter, increased JV depreciation expense as our JV network expands, and other upfront marketing and commission costs associated with those installs. As mentioned previously, we installed a total of 24 full JVs and nine hybrid JVs versus last year's 14 full JVs and eight hybrid JVs. In the case of our hybrid JVs we fully expensed those system costs during the quarter of installation.

Moving onto OpEx, SG&A, excluding stock-based compensation, was \$23 million in the quarter with approximately \$600,000 related to the new business initiatives. For 2016 we expect SG&A from our core business to be approximately \$91 million in line with 2015 levels. SG&A related to new business initiatives is expected to be approximately \$3 million consistent with last year.

R&D for the quarter was \$4.5 million which primarily reflects the development of our commercial laser product, the development of our digital delivery system and costs related to our home initiatives. Given the accelerated development of our commercial laser product we currently expect core R&D expenses of approximately \$12.5 million in 2016 and R&D related to new business investments is expected to be approximately \$3.5 million in 2016 versus \$2.8 million last year.

In total, core OpEx is expected to be approximately \$103 million to \$104 million in 2016, up about \$3 million to \$4 million versus last year. OpEx from new initiatives is expected to be approximately \$6.5 million for the year, essentially in line with 2015. We think it is important to look at the core business excluding our new business initiatives to demonstrate the underlying economics of the core. Remember that these new businesses are still in the investment stage and as such typically have an initial dilutive impact to earnings.

Our adjusted EBITDA for Q3 excluding new business and minority interests was \$31 million compared to \$30.7 million last year resulting in EBITDA margins of 36% in both periods. Digging a bit deeper our EBITDA reduction from new initiatives was \$1.8 million this year versus \$1 million in Q3 2015. The total minority interest impact to EBITDA was \$4.7 million and its impact to earnings was \$1.9 million in the quarter. We expect our full-year minority interest expense as a relates to EBITDA to be between \$19 million and \$20 million as a result of weaker box office in China over the last few months. The impact to earnings is expected to be between \$11 million and \$12 million.

Adjusted EBITDA including new businesses and after minority interest was \$24.5 million for the quarter down 6.7% from the prior year. However, please take into account that our China ownership has been reduced to 68% down from 80% in the third quarter of last year, which causes an uneven comparison year on year. Also keep in mind that the fourth quarter will be the first quarter in which we will have an apples-to-apples comparison for this metric. As minority interest was reduced to 68% in Q4 of 2015.



Adjusted net profit was \$7.9 million or \$0.12 per share in the quarter compared with \$12 million or \$0.17 per share last year. This reflects a third-quarter tax rate of 33.5% which is higher than last year as result of the overall geographic mix of box and installs. For the full year we now expect our tax rate to be approximately 25%. Looking at the balance sheet we ended the quarter with \$218 million of cash on hand. This reflects the \$15 million we spent in the quarter repurchasing 500,000 IMAX shares under our existing buyback program. Through the first nine months of 2016 we have spent approximately \$100 million under our buyback program repurchasing more than 3 million shares. We also saw a buildup of inventory is a result of the relatively large number of installs expected in the fourth quarter and the year ahead.

Before I wrap I want to highlight some new things we are trying out on the IR front. We will now be providing weekly box office results on our IMAX IR website starting next week. Our intent is to provide these updates every Friday for the prior week's box office. We believe this will increase transparency and help eliminate the guessing game that is required of analysts and investors given the difficulty in obtaining updated and precise international box office data. We've also created an IR Twitter account under the Twitter handle IMAX\_investors, which will include this box office disclosure as well as other items more relevant to our investor community. We will be trying out other disclosure and IR initiatives over time and welcome feedback and ideas from all of you.

To wrap, we have a terrific business model and with the existing network growing at a rapid pace, we are well-positioned to take advantage of the anticipated strength of the upcoming film slates. As I mentioned before, I think finance is a great role to play as a strategic partner to our business units and I'm looking forward to being a part of a very exciting time here at IMAX. At this time I would like to turn the call over to the operator for Q&A.

## **QUESTIONS AND ANSWERS**

(Operator Instructions)

Stan Meyers, Piper Jaffray.

**Stan Meyers - Piper Jaffray - Analyst**

Thank you. Good morning. Rich, I guess congrats on the record signings and installs in the quarter. I was hoping you can comment a bit more – in a bit more detail on your Wanda deal, maybe the cadence of installs, locations and maybe any other strategic plans with your largest global partner in terms of content or VR.

**Rich Gelfond - IMAX Corporation - CEO**

Sure. In terms of the signings where they are, not all of them have been identified but they pretty much follow pro rata the patterns of where we are today. In China so for example the end of last year about 17% of our theaters were in Tier One cities and our recent installs this year in China were similar with the rest cascading across the other tiers and the new deal, as I say it is not all identified, but it is generally across all four tiers of cities and again subject to filling in sites and roughly the same ratio

going forward. The economics of the deal are similar to our existing deal where we are today under that deal and there are nuances. So laser is priced differently than xenon but when you kind of step back and look at it, it is very similar.

In terms of VR we are talking to Wanda about perhaps doing a pilot location. We haven't ironed that out yet but Wanda has a great interest in VR and is investing resources in looking at it. Our relationship with Wanda continues to be very strong. As you know Wanda owns AMC and our relationship isn't only good with Wanda but it is good with AMC and AMC recently bought ODEON or hasn't closed yet and Carmike. But in connection with the signing of the ODEON deal, Adam Aron the CEO of AMC said that they expected to roll out IMAX theaters in Western Europe at ODEON and UCI locations and we are advancing those discussions and we have terrific relationship with AMC and what they are doing. So I think in general, Stan, the relationship with Wanda is excellent.

**Stan Meyers - Piper Jaffray - Analyst**

Thanks. I have one for Greg. Greg, you mentioned you know a few China drivers in the quarter and I was wondering if we've seen sort of the step down in pricing and promotion, or are we going to see more of this play out or is this sort of a one step function in Q3?

**Greg Foster - IMAX Corporation - Head of Entertainment**

Stan, I don't think you can say it's completely over. But I do think you can say that it ultimately is contingent on the titles that were there. There wasn't a lot of compelling content particularly IMAX-focused content. There was a romantic comedy. There were a handful of movies. But there was not a breakout movie over the course of the last three to six months in China.

In fact, if you look particularly in the July summer period where in 2015 you had Monster Hunt there was nothing even remotely close to that this year. Obviously the slate as it moves forward, we see some incredible titles for the Chinese New Year period and by the way we're evaluating which one of those titles to do. They have all been offered to us. And we see other titles like the Great Wall which is going to be a big hit in December in China.

So it's a cyclical process. I don't think you can say that this is how it is going forward, nor do I think you can say it is all completely done. But I think the content drives a lot of it and the content looks like it is promising as we turn the page on this last quarter.

**Rich Gelfond - IMAX Corporation - CEO**

Stan, the one -- just to give you a little more color, in China it is not the same as the US where the ticket price is fixed from film to film. In China they will charge more for a film that has more demand and less for a film that has less demand. So following up on what Greg said with Fast and Furious sequel coming out and Rogue One and things like that, I think it will be our expectation that they would charge higher ticket prices for that than for the content that was around this year.

**Stan Meyers - Piper Jaffray - Analyst**

All right. Thank you guys.

**Operator**

Steven Frankel, Dougherty Markets.

**Steve Frankel - Dougherty & Company - Analyst**

Good morning. First just, Greg, you had a mouthful of figures. Could you repeat for me what the international ex-China PSA was and what the China PSA was? Then I have a follow-up on China.

**Greg Foster - IMAX Corporation - Head of Entertainment**

Sure. Let me get my notes. The international Q3 PSA overall was \$185,000 geographically speaking, 8% growth in domestic, international ex China was \$214,000. China was \$171,000.

**Rich Gelfond - IMAX Corporation - CEO**

Accompanying this call are some slides and it is on the slide so in case you didn't get it all that time you can get it there.

**Steve Frankel - Dougherty & Company - Analyst**

Great. And then as a follow up. Now that you've been in China for a while, where do you think a normal full-year PSA ends up in China?

**Rich Gelfond - IMAX Corporation - CEO**

Well, I think it is largely film dependent as Greg just said. You know, I think we have seen a range. Last year it was around \$1.3 million as you know. It is not always dependent on the film, it's dependent on the RMB also. This year it is significantly less than that. My guess is over time, for a normal year it will be somewhere in the middle. But we will have to see.

We are opening an awful lot of theaters as Greg said in his script. Last year we opened at a very rapid pace. In fact it was 86 new theaters that we opened which was a 37% increase in China and it takes 24 months for those theaters to ripen or mature. The question is when you say normal, I mean do we mean normal with 37% growth. Do we mean normal with not a lot of good films. Do we mean normal with lots of blockbusters. I think there is all those variables. But I would say it is probably somewhere between last year and this year.

**Steve Frankel - Dougherty & Company - Analyst**

Okay. And then in terms of Japan, you made some progress there. Should we expect another good spate of orders coming from that territory in the coming months?

**Rich Gelfond - IMAX Corporation - CEO**

Well we have an extremely strong backlog from there. So I think you can expect to see installs and the new theaters that have opened, especially Toho opened two or three this year, are doing extremely well. There are some things in negotiation but I think there is something like 20 in backlog that haven't yet to open. So I think you'll see the -- actually there are 26 open and I don't remember the backlog number. But it is somewhere between 10 and 20. But I think you'll see those roll through over the next year and there is still dialogues going on. So we're optimistic about that.

**Steve Frankel - Dougherty & Company - Analyst**

On the laser upgrades and installs that you are doing currently, how are the gross margins progressing relative to where you thought they would be by this time?

**Rich Gelfond - IMAX Corporation - CEO**

I am sorry, could you repeat that?

**Steve Frankel - Dougherty & Company - Analyst**

What are the gross margin like on the laser systems? I know that they started at a very low gross margin and you had plans to cost them down or to get your gross margins up. What has happened with that year to date?

**Greg Foster - IMAX Corporation - Head of Entertainment**

I think on the GT laser product that we are installing now, that continues to be an extensive product and has thinner margins than the xenon business. Rich mentioned in his comments and I mentioned the we're spending R&D dollars right now on a commercial laser product and that is designed to be a broader application. It will have margins that are more consistent with the traditional systems.

**Steve Frankel - Dougherty & Company - Analyst**

Okay. Great. Thank you.

**Operator**

(Operator Instructions)

Ben Mogil, Stifel.

**Ben Mogil - Stifel Nicolaus - Analyst**

Great. Good morning and thanks for taking my question. So, Greg, wanted to talk to you a bit more about China and some of your comments around the ticket pricing. Certainly I think the comments that you made later on about the market or Rich made about the market being sort of one with much more dynamic pricing, so good movies, pricing moves up and vice versa. But when you look at kind for

theaters that have been open for more than a year, you sort of cycle through some of the newness if you will, can you maybe talk a little bit about what the RMB pricing trends are.

**Greg Foster - IMAX Corporation - Head of Entertainment**

The pricing has changed. We know that last year there was a proliferation of discount tickets, promotional tickets that were offered by the ticket buying services often in conjunction with the theaters. There is a little bit less of that now. The prices last year were let's say RMB10 to RMB12 and they've gone up in many locations.

**Rich Gelfond - IMAX Corporation – CEO**

Dollars.

**Greg Foster - IMAX Corporation - Head of Entertainment**

Yes, dollars. They have gone significantly up this year as the ticket buying discounts have sort of been eliminated in certain places. I think it is sort of even now in terms of becoming a little bit more consistent. But again these things happen based on the demand of the films. So, when there is not a lot of demand all of a sudden you see discounts. When all of a sudden there is a demand, it goes up. So that is sort of my answer. I do think it is stabilizing and I think as we get into a year that has such incredible brand recognition on titles like Furious 8, et cetera it will be a lot more stable.

**Ben Mogil - Stifel Nicolaus - Analyst**

In general when you say look at say a B or C market compared to an A market, what is the ticket price gap just so we can get a sense as you add more and more screens in B and C markets just sort of understand what are sort of the puts and takes. You are almost thinking about it like from a retail perspective of -- in terms of stores that you add in sort of second tier markets, if you will.

**Rich Gelfond - IMAX Corporation - CEO**

Again, we have theaters across all markets, all tiers. They are not concentrated in Tier One. As a matter of fact, as I said before there is only 17% of our theaters roughly in Tier One markets, 47% in Tier Two, 13% in Tier Three, and 13% in Tier Four markets. The prices are less variable than you would think. In the top tier markets it is higher at about RMB75 for the ticket price. But interestingly in Two, Three, and Four they are very similar. They are all grouped around RMB50.

**Ben Mogil - Stifel Nicolaus - Analyst**

Okay. And then just on Latin America. I know Brazil has got sort of specific issues given economic growth and a taxation issue. But ex Brazil, maybe you can talk about Latin America when you made some positive comments around PSAs but more on-screen installation sort of activity signings, et cetera.

**Rich Gelfond - IMAX Corporation - CEO**

As you know, our theaters are doing very well in LatAm and they have been doing better as Greg said in his comments. And I think our head of sales, Don Savant, is pretty enthusiastic about LatAm and in fact in an earlier draft of our speech we addressed this question. But you know I have just been around too long and the combination of the taxes and the currency fluctuations, I don't want to go out on a limb. Maybe the PSA growth translates into rapid theater growth but I am more cautious about that. It's certainly a necessary predicate, what is happening. But is it sufficient or do you need more currency stability on let's wait and see.

**Ben Mogil - Stifel Nicolaus - Analyst**

That is great. Thanks, Rich. Thanks, Greg. I appreciate the color.

**Operator**

Alexia Quadrani, JPMorgan.

**Alexia Quadrani - JPMorgan - Analyst**

Thank you. Just sort of back on China specifically on the local language film there. Can you expand a bit on your strategy there. You mentioned there are a bunch of films coming up and you evaluate them sort of film by film. Is that still the plan, kind of just sort of take them as they go or do you have a bigger maybe broader commitment to sort of expand your commitments to the local language film?

And then also you mentioned the new theater conversions are ramping up, it takes a while before they become really beneficial to the system. I guess any sense and when you look at 2017 is that still a headwind or does that eventually convert into a tailwind for 2017?

**Greg Foster - IMAX Corporation - Head of Entertainment**

This is Greg. I am going to talk first about the pictures and then Rich can talk about the theater growth. What we are doing is we are fully committed to the local language films and we will continue to be and we do so in concert with the Hollywood films. During the so-called blackout periods which would be December, which would be Chinese New Year; which would be October. We tend to have a variety of options to pick from.

Let's talk for instance, I'm not going to get into the titles because I don't want to put anyone in a bad spot but there have been a handful of titles that have been offered to us for the Chinese New Year and we are going to pick what we think is the best title. In the past, we have picked a little early, often before actually seeing the films. And now we have put ourselves in a position that we are able to actually watch the movies before we pick. We will be doing that over the course of the next month or so. I would say in the end of December, for the Chinese New Year title we will announce which one we are going to do.

But we will continue to have 6, 8, 10 local language Chinese films throughout the year in the film slate and we have seen great results with many of them. Some of them are gap fillers and don't do as well like a regular Hollywood business. But it is a big portion of our Chinese business and it is something that is also terrific about building up our relationships with Chinese filmmakers and studios. And we also have an inclination to begin to include IMAX DNA, IMAX cameras into Chinese productions to go with our Chinese film fund. We are fully committed to it going forward.

**Rich Gelfond - IMAX Corporation - CEO**

Alexia, I think it is both. You asked is it a headwind or a tailwind, the new theaters. The tailwind pushing us forward is the network growth in China is extremely rapid, don't remember the exact number but in the fourth quarter there is a lot of installs going on back-end loaded now in China. And then for next year, as I said the install guidance has picked up worldwide and a lot of those are coming out of China.

So when you look at it as a percentage, again this is rough, so every disclaimer at the beginning holds here. But I think that we're looking at a post 30% network growth in China again next year and even higher if you look at the quarter. So yes it is going to take a while for those to mature. But on the other hand, the 86 we installed since third quarter last year are going to be open for a year and they will increase. How that develops in an equilibrium is too complex an algorithm for me to do at the moment. But I think it is both a tailwind and a headwind.

**Alexia Quadrani - JPMorgan - Analyst**

Rich, you mentioned earlier or talked a bit about the dynamic pricing in China. Do ever see that model or at least for the IMAX theatres coming here in the US?

**Rich Gelfond - IMAX Corporation - CEO**

No. As I am sure you know the studios have talked about dynamic pricing for a long time and the exhibitors have discussed it as well. So for those on the call who aren't familiar with the concept, it would be when you are showing Star Wars, do you charge \$3 more than when you are showing a small romantic comedy. But neither the exhibitors nor the studios have really embraced that model in the US. But China kind of grew up later as a market and that is not official but it is more embedded in the Chinese ecosystem.

**Alexia Quadrani - JPMorgan - Analyst**

Thank you very much.

**Operator**

Jim Goss, Barrington Research.

**Jim Goss - Barrington Research Associates, Inc. - Analyst**

Thanks. First, Greg, congratulations on your promotion. You were given the board seat. And maybe for you or Rich, the notion of the programming mix continues to evolve. I am wondering if at this stage what you think is the optimal number of films per year and how you allocate the screen time. You ticked off at least one or two potential and major blockbusters every month in 2017. Do you tend to -- are you tending to allocate two weeks or three weeks as an initial thought depending on whether it is going to work and then fill it in with a couple of others, or how is that progressing at this stage?

**Greg Foster - IMAX Corporation - Head of Entertainment**

Jim we -- first of all thanks for the thing on the board. Secondly, we're trying to show as much flexibility as possible. For instance, you recall last year we didn't play The Lego Movie. This year we have two Lego movies in 2017 on our schedule. We often play movies for three or four weeks. Certainly in the past we did them a lot more frequently. That has come back down a little bit. I would say the average movie is probably two weeks, but we probably have -- not probably we definitely have a lot more one week movies than three week movies. But then when we have a title like a Star Wars or a title like a Chris Nolan movie, we are going to really dig in and play that movie because it is innate to our DNA.

We have to be flexible. We will be flexible. What we're not going to do is come up with these religious statements of we don't do that. We're open for everything. We're open for what we think creates the most compelling content 52 weeks a year. Sometimes it will be one week. Sometimes it will be two weeks. Sometimes it will be three weeks. Everyone once in a while it will be four weeks.

We do this also very much in concert with our exhibitor partners. We are in constant contact with them. They certainly have a strong point of view on certain things. And we listen to them because they are our partner. We also work with the studio and we also usually tend to honor the relationships and the filmmakers who mean an awful lot to us. There is no hard and fast rule. It is not as simple as a science. There's definitely some variability to it. But I would say in general, we are more inclined to play things for two weeks now than we used to which would be three or four.

**Jim Goss - Barrington Research Associates, Inc. - Analyst**

With the continued evolution of programming in China, are you getting any sense that any of the Chinese products could travel well to the United States or are we still not quite there yet with subtitles, or however it would work?

**Greg Foster - IMAX Corporation - Head of Entertainment**

I think we are moving in that direction. Jim. I think that is certainly the plan when you meet with people and understand kind of the long-term goals of the Chinese studios and the government. It is definitely to become -- not just to make movies for internal consumption but to make them for export as well. And it is starting to kind of trickle. We have done some of them in IMAX. It is our only mixed results. But I think over time you're going to see more of that. But I don't think that is an imminent development in the industry.



**Jim Goss - Barrington Research Associates, Inc. - Analyst**

One final financial sort of thing. Sales type lease ads tend to add a penny or something of that nature, rule of thumb, to EPS. When you have the hybrid JV type structure, does that also have that blended a little bit of the JV and therefore that there would also be an initial favorable impact in the quarter when the addition takes place?

**Patrick McClymont - IMAX Corporation - CFO**

The hybrid JVs you end up expensing the system cost upfront and then there is the typical installation ramp up expenses. The initial impact is going to be a drag and then you are sharing on the economics over time. The IRR of the project is quite attractive. But the initial upfront is an expense.

**Jim Goss - Barrington Research Associates, Inc. - Analyst**

Okay. Thank you very much.

**Operator**

Robert Peters, Credit Suisse.

**Robert Peters - Credit Suisse - Analyst**

Great. Thank you very much for taking my call. Greg, I was wondering you gave us some really great color on the 2017 and 2018 film slate with a number of good Hollywood titles coming out. But I was wondering when you look at that film slate for China, is there any of those Hollywood titles that you think will do well in those markets? For example, in the past we've seen titles like Fast 7 do extremely well but other titles like Star Wars haven't gotten as much traction. I was just wondering if there was anything that jumped to the front of your mind when we look forward to the international film slate?

**Greg Foster - IMAX Corporation - Head of Entertainment**

Certainly you're going to see great results from Disney. We saw what happened for instance with a title like Zootopia last year where it did such huge business. I suspect that Beauty and the Beast will do remarkably well and the animation titles do really well there. Furious 8 is going to be giant. Furious 7 was a massive title there and I think that the pent-up interest in seeing that movie in China will be very strong.

Transformers has China DNA in it for several titles now. That until recently was the highest grossing Hollywood title in all of China. So I have no doubt that will do remarkably well. I think Guardians will do well also. There is just so many of them. Spiderman has tended to do particularly well in China. And then I think there are titles that are co-productions if you will. So for instance, the Great Wall. I'm confident that the Great Wall in China in particular will do very, very well. I don't think that there will be a shortage of high-performing titles over the course of the next 12 months. There's often other ones that come out that surprise you.

For instance, in June, and who knows if it is getting in, I am sure it will but there is the Kingsman that is coming out from Fox and the Kingsman last year, the original one, that's Kingsman 2 did great business in China. By the way there is also movies like Despicable Me 3 that are coming out. I could just keep going down the list. There is quite a lot to choose from. I would anticipate that 2017 has some more traditional home runs than 2016 has had.

**Robert Peters - Credit Suisse - Analyst**

Perfect and maybe just a follow-up on that. If we look at the quota, I believe the next round of WTO negotiations is starting in 2017. I'm just wondering if you guys could share any thoughts you might have on the current quota system and kind of where you see that going over the long-term?

**Rich Gelfond - IMAX Corporation - CEO**

There are a number of open issues between China and the US in terms of film distribution in China. I will name three of the major ones. There are more than that. But three of the major ones. One is as you say, the quota. Another one is the studios pay [great]. Another is the distribution pattern being dominated by China Film Group. I think those are the primary issues for discussion and the talks in 2017. I don't think that all three of those are going to break one way or the other but I think there will be some adjustments as a whole that will probably -- what's the word that I am looking for -- probably be favorable to the Hollywood community. But how that gets divided up and which ones they are, they don't know, and we don't know yet.

**Robert Peters - Credit Suisse - Analyst**

Fantastic. Thanks, Rich. And maybe just one last question and I will pass the line. When you're looking at obviously increasing your film count and offering more international titles and being flexible, I am wondering if you could just talk about any trends you are seeing in DMR costs on a per title basis? Do you see that going up over time, or is there some way you can look to improve that process and reduce the cost?

**Greg Foster - IMAX Corporation - Head of Entertainment**

They are definitely coming down. You have to remember that there are certain titles, particularly if we have cameras in use or aspect ratio where we are going to surround that movie and make sure that it is done with multiple passes to ensure that it is the best version of the IMAX experience.

For instance, doing an animated title tends to be a little less expensive than doing a live action title. It's not something that -- we are not cutting the cost in half, but I would say it is a 5% -- 5% to 10% reduction and it is something that we are working on. We also have more teams doing it which helps make it more efficient. So we don't have to have as much overtime. I think that is something that is very important. That is on the actual physical production DMR.

Part of that is offset by the fact that we are also contributing more marketing to the titles. It is very important to us that we make sure that people know that these are IMAX movies and we work very

closely. Eileen Campbell, our CMO and her team work very close with our studio partners on the marketing side. So it is a little bit of lower the cost on one end but then add some of it back into the marketing to make sure that people are buying tickets. It works hand in hand. We have also found great cooperation with the marketing departments at the studios and with exhibition because of the strength of our slate particularly going forward. It is a little bit of a take some from one hand and move it to the other.

**Robert Peters - Credit Suisse - Analyst**

Thank you very much.

**Operator**

(Operator Instructions)

Aravinda Galapathige, Canaccord Genuity.

**Aravinda Galapathige - Canaccord Genuity - Analyst**

Good morning. Thanks for taking my question. Rich, I was wondering if you can just touch on the buybacks. Obviously, \$100 million is pretty sizable but we have seen the buyback dates that have eased a little bit as we get into Q3. So given your balance sheet and the fact that arguably the stock not responding as well as would like, given -- to the strong signings, maybe just touch on your thoughts going forward about maintaining that momentum.

**Rich Gelfond - IMAX Corporation - CEO**

As we said at the beginning, we thought the stock was a good investment. We thought that we were going to be opportunistic is what we said. And I think we have followed through on that, Aravinda. We have our plan is \$200 million that was voted in by the Board. Patrick is looking for the number. But we bought in 100 this year and we bought in some more than that last year.

**Patrick McClymont - IMAX Corporation - CFO**

A little bit less than 160 all in.

**Rich Gelfond - IMAX Corporation - CEO**

160 all in. We told you what we were going to do. We're on the road to doing what we're going to do. I think we will evaluate it. As I said, earlier with VR and our content strategy, we're not really using a lot of cash right now. However, should we get convinced that those are good initiatives, with good IRRs, I think just like on our JVs, I think we would use cash at that point. So I think given that we still have room under our existing board program, it is too early to discuss what we will do after that.

**Aravinda Galapathige - Canaccord Genuity - Analyst**

Great. Thank you, Rich.

**Operator**

Darren Aftahi, Roth.

**Darren Aftahi - Roth Capital Partners - Analyst**

Good morning. Thanks for taking my questions. Just a couple if I may. Do you exclude Wanda in your signings this year? Do you kind of look at it -- kind of the outlook going 12 months forward. What is your kind of sense on the cadence of theater signings? And secondarily on your Warner Bros. re-up deal, any material change on the DMR piece? Thanks.

**Rich Gelfond - IMAX Corporation - CEO**

No material change on the DMR piece going forward. We do have different discussions with the studios about marketing support. I think as we go forward they are certainly encouraging us to do more of that and spend more on the movies and as Greg just said we are doing that.

In terms of signings, if you exclude the Wanda deal, which I don't know why you would, but happy to do hypothetical. So it is 295 less 150, which is 145, which still beats last year, and still beats most years, and we have a quarter to go. So I am feeling really good about signings. There's lots of activity around the world, even excluding the Wanda deal.

By the way, by way of color in my remarks, I talked a little bit about Europe but France is a territory that has been relatively slow to develop but Pathe has had tremendous results from the theaters they opened, especially their two laser theaters and that lead directly to the new deal in Belgium. I'm excited about opening our first theater with Kinopolis. And Japan. The results have been extremely good. You have to remember that is with a stronger US dollar. So it is translating in ways that -- less than it would have translated a year ago. But France's PSAs were up 10% in the third quarter and as Greg mentioned, Latin America is doing very well. So it is not just the China story, but the China story is a pretty good one.

**Darren Aftahi - Roth Capital Partners - Analyst**

Thanks.

**Operator**

Eric Wold, B. Riley.

**Eric Wold - B. Riley & Co. - Analyst**

Thanks. Good morning. A question and a half I guess on virtual reality. I know it is early, Rich, and you mentioned in the beginning that you will kind of focus that model sort of the JV model here. I guess, one, is that kind of the sole focus of that or is there a situation where we could see, depending on the market and the partner, kind of a three-pronged strategy like we have with the core cinema business in terms of an upfront hybrid and then JV? And then second part on content, as you think about the content deals you will be striking for those VR experiences and kind of competition at home with

gaming, et cetera, what you envision the split to be in terms of exclusive content, like maybe you're the only place you can fly the Millennium Falcon for Star Wars and Lucas and all of that versus maybe more generic VR content deals otherwise that aren't nonexclusive?

**Rich Gelfond - IMAX Corporation - CEO**

Eric, you know our business very well. So I think even though in the short term we are doing JVs. In the long-term I would not exclude it evolving in virtual reality the way you suggest. So again today we won't do JVs in Russia because of transparency and political risk and things like that. If we go into Russia, I would expect we would follow a similar model.

We think this is a very huge opportunity. And if we could do a big deal where someone wanted to own and operate a number of them and give us a really good margin, I think we would be very open to doing that also. But our preferred way of going is going to be the JV and we think especially early on we are going to create a terrific product with our great brand that people are going to want and we're going to drive it to the JV model but we are open-minded.

In terms of content, I think it will follow similar to the way the industry works now. I think content will go through windows. There will be VR content. The first window would probably be IMAX location-based entertainment and maybe certainly eventually there will be others that evolve out of home that I think they will cascade into other windows including in-home windows earlier in the game. I think there will be opportunities to have exclusive IMAX VR windows.

We're looking at bringing in different financing partners to maybe do that where we could profit on both the content side and the distribution side. But I think it is going to be a developing market. And this is just a guess. But my guess is it will develop consistent with the way the cinema market developed.

**Eric Wold - B. Riley & Co. - Analyst**

Thank you.

**Operator**

Eric Handler, MKM Partners.

**Rich Gelfond - IMAX Corporation - CEO**

This is our last question so go ahead, Eric.

**Eric Handler - MKM Partners - Analyst**

All right. Thanks for getting me under the wire, Rich. Your install outlook for next year I thought was great and probably better than most people had anticipated in their models. And when you combine that with on paper what looks to be a very good film slate, the revenue outlook for the company has the potential to be very strong next year. My question is, when you look at your expenses, are you

committed to allow for margins to expand to a level of at least that 37%, 38%, 39% range that we've seen over the last several years or maybe even getting closer to 40%?

**Rich Gelfond - IMAX Corporation - CEO**

Eric, as you know, because you know us very well, we do not look at it that way as targeting a target margin. We do have a lot of installs next year on the outlook. But you have to be clear. A lot of them are JV installs. So it is not going to be a one-time revenues coming in. So you have to account for that.

Expenses were always focused on the margins, and if you saw our SG&A growth this year was in line for the core business or maybe better than we thought it would be going in to the year. However, following up on the last question by the other Eric, we are obviously trying to grow our business in different ways too. So I think as you look at the business and you separate it, we're going to try to be a little more transparent on this going forward. When you look at the core business, I think we are very focused on the operating margins, and we are very focused on improving them.

That doesn't mean we are not going to invest in other businesses that we think show promise. And as I said earlier, we're not going to invest a lot of money, but we are going to dabble until they see if they work. If they work we are going to invest in more money. So it depends on how you look at it.

I think partly analysts as insightful as you are will be able to understand that the core business margins are expanding, and we are investing them in the new business now and you're going to have to make a judgment as they come together whether those are good businesses and we know what we're doing, and we should spend more, or they are not. And I sorry I know that was a very long answer. But the short answer is we're very focused on margins. That is a good point to kind of conclude the call.

As we said during the call, kind of my two sentence summary is, if you are a long-term investor in IMAX and you look at in terms of long-term success, things like network growth, it is things like PSAs and new territories. It is things like backlog. It is things like what other opportunities we are looking at. Unfortunately from a box office point of view it wasn't one of the best quarters ever. But we think box office tends to be ephemeral.

So hopefully when we are there on our next call after Rogue One and after Fantastic Beasts and Doctor Strange and the 2017 slate, we will see our long-term strategy come into financial focus. Thank you all very much.

**Operator**

Ladies and gentlemen there are no further questions. I would like to hand it back over to our speakers for closing. This concludes today's call. Thank you for your participation. You may now disconnect your lines.