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RGC - Q2 2015 Regal Entertainment Group Earnings Call

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OVERVIEW:

Co. reported 2Q15 total revenues of \$862.8m.



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PRESENTATION

Operator

Good afternoon. My name is Devon and I will be your conference facilitator today. At this time, I would like to welcome everyone to the Regal Entertainment Group fiscal second-quarter 2015 earnings release conference call, with our host, Amy Miles, Chief Executive Officer of Regal Entertainment Group; and David Ownby, Chief Financial Officer of Regal Entertainment Group. All lines have been placed on mute to prevent any background noise. After management's remarks, there will be a question-and-answer period. (Operator Instructions)

I would like to remind our listeners that this conference call contains forward-looking statements within the meaning of the Section 27A of the Securities Act of 1933 as amended, and Section 21E of the Securities Exchange Act of 1934 as amended. All statements other than statements of historical facts communicated during this conference call may constitute forward-looking statements. These forward-looking statements involve risks and uncertainties.

Important factors that can cause actual results to differ materially from the Company's expectations are disclosed in the Risk Factors contained in the Company's 2014 Annual Report on Form 10-K dated March 2, 2015. All forward-looking statements are expressly qualified in their entirety by such factors.

Today's call and webcast may include non-GAAP financial measures. A reconciliation of these non-GAAP measures to the most directly comparable financial measures calculated and presented in accordance with GAAP can be found in today's press release on the Company's website, www.regmovies.com.

Now I will turn the call over to Amy Miles.



Amy Miles - *Regal Entertainment Group - Chair of the Board and CEO*

Good afternoon, everyone, and thank you for joining us this afternoon. We are here to discuss our second-quarter financial results with the investment community. But first, let me say that our thoughts remain with those affected by the horrific event that transpired in Louisiana last Thursday night.

We believe that the movie theaters have always been and will continue to be places where friends, families, and communities can safely gather together for a few hours of fun and entertainment. We were heartbroken by the senseless act that took place last week. And on behalf of everyone here at Regal Entertainment Group, we extend our deepest sympathies to the victims, their families, and the Lafayette community.

With that in mind, we'll move on to a discussion of our second-quarter results. First and foremost, we are extremely pleased that a robust box office environment, our continued rollout of premium customer amenities, and our continued focus on managing the variable portion of our cost structure, enabled us to generate record total revenue in the second quarter, and the second-highest adjusted EBITDA total in our history.

When we spoke to you in late April, we indicated that industry box office results for the first few months of the year were keeping up with the lofty expectations set by Wall Street and other industry pundits. I'm happy to report that today, almost 7 months into 2015, that is still the case. With a record take of almost \$3.1 billion in the second quarter and a 19% increase so far in July, record year-to-date industry box office results of over \$6.6 billion are 8% ahead of last year's total, and are tracking ahead of the previous record mark set in 2013.

Also, many of the factors that drove our success in the first part of the year continue to have a meaningful impact on our results in the second quarter. The 278 screens that were converted to reclining seats, in the 12 months prior to the end of the first quarter, outperformed the industry box office by over 6,100 basis points, and contributed an incremental \$10 million of box office revenue. Our 174 premium auditoriums, both IMAX and RPX, contributed over \$14 million of box office revenue growth, and helped push our average ticket price to an all-time high of \$9.62.

The six newbuild theaters we opened late in 2015, all of which feature reclining seats, generated almost twice our overall average box office per screen. And our new offerings at the concession stand, combined with strategic price increases, continue to drive revenue growth, enabling us to achieve a record quarterly concession per cap of \$4.19.

David will go through the particulars of our quarterly numbers later in the call, but when you combine the revenue growth associated with our efforts to enhance the customer experience with our proven track record of controlling operating costs, it's easy to see why we are optimistic about the remainder of 2015 specifically, and the future in general. With that in mind, I'd like to spend just a few moments providing an update regarding our key initiatives.

First and foremost, our installation of luxury reclining seats is continuing at a healthy pace, with an additional 188 screens converted so far this year, and another 201 screens currently under construction. We are still on schedule to convert approximately 40 buildings, with around 500 screens in 2015, and should end the year with a total of 850 screens fully equipped with recliners.

And this is only the beginning. As we look ahead into 2016 and 2017, we have a long runway of opportunity, and ultimately expect to outfit at least 2000 screens with luxury seating.

Second, our low-cost, low-risk investment and the equipment necessary to provide an enhanced menu and alcoholic beverages to our customers, continues to have a more meaningful impact on our concession revenues, adding almost \$0.10 to our concession per cap in the second quarter.

We continue to add new locations to our list of theaters that feature these offerings at the rate of roughly 3 sites per week and expect to end 2015 with 185 theaters serving the enhanced menu and 135 sites with some type of alcoholic beverage service.

And third, as is always the case, we will continuously be on the lookout for industry acquisition opportunities at attractive multiples. While prudent opportunities have been slow to materialize recently, we do believe that a healthy 2015 box environment and the necessary capital investment and luxury amenities may serve as motivations for sellers in the relative near-term.

We believe that our focus on customer amenities and accretive acquisitions, combined with the studio's commitments to theatrical release dates throughout the calendar year and well into the future, will enable us to generate meaningful return for our shareholders, long after a hopefully record 2015 box office has come and gone. We are extremely excited about the potential for growth and financial returns associated with these initiatives, and we look forward to updating you as they progress.

And finally, before I turn the call over to David, I'd like to take a moment to address the numerous questions we receive regarding Paramount Pictures' proposed test of a shorter theatrical window for two upcoming horror films. First of all, we appreciate Paramount's willingness to seek exhibitor input and provide for exhibitor participation in certain ancillary revenues, as they evaluate alternative business models. However, the parameters of the current proposal, both economic and structural, simply do not make sense for us, given the potential risk to the long-term health of our business.

As has been the case historically, we will utilize our screens to exhibit films that are distributed using a traditional distribution model that respects the existing theatrical window.

In summary, we are extremely pleased that a healthy box office environment, combined with the impact of our recent investment in the customer experience, and our continued focus on managing the variable portion of our cost structure, enabled us to generate record adjusted EBITDA of over \$305 million for the first half of 2015.

I'd now like to turn the presentation over to David for a discussion of the financials.

David Ownby - Regal Entertainment Group - EVP, CFO, and Treasurer

Thanks, Amy, and good afternoon, everyone. For the next few minutes, I'll provide a brief analysis of our second-quarter results, and an update with respect to our balance sheet and asset base. But before we get to the numbers, a couple of housekeeping items.

First, as a reminder, please note that we have updated our computation of adjusted EBITDA as it relates to our earnings from National CineMedia. Historically, we have included our GAAP equity method earnings from NCM in that computation. In an effort to more closely align our reported adjusted EBITDA with our operating cash flow, beginning in the first quarter, and on a go-forward basis, we now include our quarterly cash distribution from NCM in adjusted EBITDA.

This change is reflected for all periods presented in the reconciliation of EBITDA to adjusted EBITDA in our press release. And second, the comparability of our quarterly results in 2015 to those in 2014 is impacted by the timing of our fiscal calendar. Our first two fiscal quarters last year totaled 182 days, and included six days from the week between Christmas Day and New Year's Day, a traditionally high attendance period for the Company and the industry.

This year, our first two quarters totaled only 180 days and did not include any days during the Christmas/New Year's week. The shift in our calendar had a significant positive impact on our results for the fourth quarter of 2014, a corresponding negative impact on our results for the first quarter of 2015, and a mildly positive impact on our results for the second quarter of 2015.

With that in mind, for our fiscal second quarter, we generated total revenues of \$862.8 million, including \$568.6 million of box office revenue, \$247.7 million of concession sales, and \$46.5 million of other operating revenue. Our admissions revenue for the quarter grew by approximately 10% in the aggregate and 10.5% on a per-screen basis, benefiting from both a 5.3% increase in attendance and a 4.3% increase in our average ticket price.

A significant increase in the percentage of our box office revenue generated by premium format films, and strategic price increases in many markets, helped drive our average ticket price to an all-time high of \$9.62, \$0.40 higher than the same quarter last year and \$0.34 higher than the previous record set in the fourth quarter of 2013. Our concession revenue increased by almost 17% in the aggregate, as concession sales per patron of \$4.19 grew by 10.6% and bested our previous record high by \$0.27.

As has been the case for the last several quarters, strategic price increases, improvements in popcorn and beverage volume, and the continued success of our enhanced food menu and alcoholic beverage offerings, all contributed to the increase, and helped drive the highest quarterly growth in our concession per cap since 2007. Other operating revenues grew by \$5.5 million as compared to the same period last year, due primarily to increases in revenue from our vendor marketing programs, contractual revenues from National CineMedia, and revenues from our advanced ticketing and gift card programs.

While we are always happy to see improvements in the top line, it is incumbent on our management team and field personnel to make sure increased revenue translates into increased adjusted EBITDA and margin expansion. And once again, we were extremely pleased with our operational execution during the quarter.

Our film and advertising expense of \$314.7 million represented 55.3% of admissions revenue, 240 basis points higher than the same period last year, and in line with the end -- with the high end of the historical range. While it's clear that our film and advertising costs for the quarter were largely driven by a film slate that relied heavily on a few high-grossing films -- most notably Jurassic World and Avengers Age of Ultron, which together, accounted for roughly one-third of second-quarter industry box office revenue -- I'll also point out that the quarter-over-quarter increase was impacted by relatively low film rent and advertising costs in the second quarter of last year.

Our 86.1% concession margin decreased 60 basis points as compared to the same period last year. Slight increases in raw material and packaged good costs, the continued growth of our enhanced food and alcoholic beverage programs, and the amount of vendor marketing revenue recorded as a reduction of cost of concessions, all contributed to the cost increase during the quarter.

Total rent expense of \$106.6 million increased by \$0.3 million in the aggregate and by less than 1% on a per-screen basis. An increase in contingent rent associated with our increases in box office and concession revenue was the primary driver of the per-screen increase, and was partially offset by the ongoing impact of restructuring and existing master lease covering nine of our properties in the first quarter.

Total other operating expenses of \$214.7 million increased by approximately 5.5% as compared to the same period last year. Although increases in theater level payroll costs in response to increased attendance levels, and increased equipment royalty payments associated with the increase in our premium format box office revenue, had a negative impact on this particular line item, the corresponding impact on our box office and concession revenue benefited our results as a whole, and helped drive a 160 basis point improvement in our adjusted EBITDA margin.

As Amy mentioned earlier, the year is off to a great start, and we are pleased that the healthy increases in our average ticket price and concession per cap, combined with our operational execution, enabled us to generate second-quarter adjusted EBITDA and adjusted earnings-per-share ahead of consensus Wall Street estimates. And as for our asset base and our balance sheet, capital expenditures net of asset sales and landlord contributions for the quarter totaled \$38.2 million. And we continue to actively manage our asset base, closing one theater with 10 screens to end the quarter with 569 theaters and 7,324 screens.

Based on our development schedule and the outlook for the remainder of the year, we still expect full-year capital expenditures to be between \$135 million and \$145 million. We expect to open two newbuild theaters with 24 screens, and close 8 to 10 theaters with 70 to 90 screens, which would result in ending counts of approximately 567 theaters and 7,311 screens for 2015.

With respect to the balance sheet, in early April, we took advantage of a favorable leverage loan market to extend the maturity of our senior credit facility for an additional five years through 2022, and, as a result, included a \$5.7 million debt extinguishment charge in our earnings for the current quarter. While the extension came with a slightly higher interest rate, our top priority was maintaining the flexibility in our capital structure by eliminating any remaining near-term refinance risk. And we were extremely pleased with the outcome, given the market conditions.

With our current capital structure and interest rate swap portfolio, we expect our interest expense to be approximately \$33 million per quarter for the remainder of the year. And as of the end of the quarter, our overall leverage ratio was 3.5 times net debt to adjusted EBITDA.

In closing, again, we are very happy about our results for the first half of 2015, and we remain excited about the opportunity to further enhance the customer experience and the potential for box office success for the remainder of the year.

Operator, this concludes our prepared remarks. You can now open the lines for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Eric Handler, MKM Partners.

Tyler Seidman - MKM Partners - Analyst

This is actually Tyler Seidman filling in for Eric Handler. Thanks for taking my call. I'm wondering -- so there is always a discussion about increased M&A opportunities following a record box office year. And I'm wondering if you are getting a sense that there might be willing regional operators looking to sell next year, if, in fact, there is a record box office this year?

Amy Miles - Regal Entertainment Group - Chair of the Board and CEO

I think what we said earlier in our prepared remarks is we look at deals that have happened over time. We think it's a good environment today to spur future M&A activity. And we talked about that from two perspectives -- one being the healthy box office environment, particularly as we talk about record 2015 box office. And also we are seeing a lot of investment in luxury or consumer amenities today, which brings with that an associated capital cycle. So, those are two things that we think are good for spurring the M&A environment.

Tyler Seidman - MKM Partners - Analyst

Great. Thank you very much.

Operator

Ben Mogil, Stifel.

Ben Mogil - Stifel Nicolaus - Analyst

Thanks for taking my question. And a nice quarter, for sure. This is sort of more of a question -- kind of more of a Board question, but I'm sort of curious of your view as well. I mean, you've really kind of made a pretty dramatic shift in the last sort of year from being up for sale to really increasing the amount of capital you are doing, not only this year but clearly the targets you are setting up in terms of recliners, in terms of retrofits for food and beverage are clearly going to be 2016, 2017 higher levels of CapEx than what we've seen over the last couple of years. Do you get a sense that there's sort of a view internally that they have been maybe underspending for too long and now this is kind of what's needed to go to keep up on a more near-benchmark kind of numbers? I'm kind of curious the metamorphosis, if you will, around -- philosophically around these issues.

Amy Miles - Regal Entertainment Group - Chair of the Board and CEO

Sure. Let me try to put that in perspective for you, Ben. The strategic plan that we had in place prior to the announcement of review of strategic alternatives, which included a potential sale of the company, included the CapEx and the investment in the asset base that you see today. But in the board and doing what they need to do from a fiduciary perspective, you always want to make sure, particularly in a time period before you're about to commence with a strategic plan that does have an increased level and capital in capital to make sure that you've considered every alternative that would bring the highest and best return to your shareholders. So I think the best news from that strategic review was such that it



was a confirmation of the strategic plan that we had in place a couple of years ago. And from that perspective, we feel really good about the strategy that we are executing, because we've done everything we can to make sure that we've considered all possible alternatives.

Ben Mogil - *Stifel Nicolaus - Analyst*

That sounds very reasonable. Thank you, Amy.

Amy Miles - *Regal Entertainment Group - Chair of the Board and CEO*

Sure.

Operator

Ryan Fiftal, Morgan Stanley.

Ryan Fiftal - *Morgan Stanley - Analyst*

I wanted to ask about the re-seating initiatives so far. So, I know you put out a statistic for the outperformance of those screens. I was wondering how is that comparing to your expectations? A couple of quarters ago, I think you talked about a 30% cash-on-cash return. I was wondering now that you have more data, how that's coming in versus your expectations? And also if you have any better visibility into how much of the attendance uplift you think is primary versus share gain? Thank you. Thank you.

David Ownby - *Regal Entertainment Group - EVP, CFO, and Treasurer*

Hi, Ryan, it's David. I'll try to take that for you. Amy did mention that the outperformance in her remarks, that those screens that she mentioned, the 278 screens that have been converted kind of since the beginning of the second quarter last year, were up about 72% in total box office for the -- for this quarter. And when we drill down and try to analyze that, it's always a little bit difficult sometimes to segregate how much is related to share gain and how much was related to actual market growth.

But generally speaking, I think we view that as about half and half. Some markets, it's more share gain; other markets, it's more market growth. But when you put it all together for that bucket of theaters, it looks like it's roughly half and half.

And then, as you try to translate that box office growth into a return on investment for those projects, 30% has kind of been -- we put that number out there early on, and that was kind of the minimum of what we were seeing. And that's still the case. Some of those projects, depending on what the landlord dynamics are, are at that 30% level. Many of those projects are much higher than that number.

Ryan Fiftal - *Morgan Stanley - Analyst*

Okay, great. Thank you.

David Ownby - *Regal Entertainment Group - EVP, CFO, and Treasurer*

Thank you.



Operator

Robert Fishman, MoffettNathanson.

Robert Fishman - *MoffettNathanson LLC - Analyst*

I have one for Amy and one for David, if I can. Amy, so Netflix has largely been credited with the changing -- the way that people consume TV, allowing them to watch content where and when they want. Do you worry at all that Netflix's foray into movies, and now with Paramount's experiment to shorten Windows, is that the reason for not joining in either of those, to protect the existing ecosystem? And does the confidence that you have from the record box office kind of push you in that direction?

Amy Miles - *Regal Entertainment Group - Chair of the Board and CEO*

Yes. I'll try to answer the question with a little bit more broader response, and then you can tell me if I'm missing any of your specific points.

Robert Fishman - *MoffettNathanson LLC - Analyst*

Sure.

Amy Miles - *Regal Entertainment Group - Chair of the Board and CEO*

I think when we think about the overall environment, there's some key themes for us. First and foremost, we do think that our long-term success is obviously highly correlated to the long-term success of our studio partners. And we also think that we and the studios mutually benefit from a healthy film content ecosystem.

So in keeping with those themes, we would be open to any idea, any discussion, any test, any experiment that we think has the potential to grow that overall pie. But that's as long as any associated economic arrangement provides us a financial participation that is greater than or at least equal to the risk that we are undertaking.

That's clearly not the case with this Paramount proposal, and it's never been the case with any type of Netflix discussion. So I think that's the overall arching themes and the perspective that we have here, with respect to these two points of your question.

Robert Fishman - *MoffettNathanson LLC - Analyst*

Okay. No, that makes sense. And for David, so there's clearly been a focus on film costs this quarter. I understand in your prepared remarks how you laid it out. But do you think there's at least some degree of the higher costs related to the increases that the studios have been pushing over the past year leading up to this highly anticipated slate that should continue going forward? Or is it more just the anomaly with the concentration at the top of the box office?

David Ownby - *Regal Entertainment Group - EVP, CFO, and Treasurer*

Yes, the single biggest driver here in this period is just that concentration of the box office. If you look at how that compares just historically, maybe for the second quarter, the top three films this quarter were about 43% of the box office -- that's Jurassic World, Avengers Age of Ultron, and Furious 7. The average concentration for the last six or seven years for Q2 is about 30%. So it's pretty easy to see there why you quickly -- that number starts to quickly go up when you get that kind of concentration.



I'll always kind of point you back to a maybe a -- always looking at that on a 12-month number as opposed to a quarterly number. And if you look at the last 12 months just ended -- I think that I'll use the top 10 films here -- but that number is just under 30% of the box office. And that number is equal to the concentration we had in 2010 and 2012.

And our film rent over that time period, whether you look at the last 12 months or those other years I just mentioned, you'll see that it's very similar to those other years. So, I think what you -- again, the primary driver here is simply the concentration in the film slate.

Robert Fishman - *MoffettNathanson LLC - Analyst*

Okay, thank you both.

David Ownby - *Regal Entertainment Group - EVP, CFO, and Treasurer*

Thank you.

Operator

Barton Crockett, FBR Capital Markets.

Barton Crockett - *FBR Capital Markets - Analyst*

Okay. Thanks for taking the question. I was wondering about the visibility of the benefit from the initiatives, particularly the re-seats in your admissions revenue. A sense of when you think we might be able to start seeing that drive outperformance relative to the industry costs. Because it looks like this quarter, even with the great performance in the re-seats, it looks like you guys were up about 10.5% or so per screen year-over-year. The industry on a comparable basis was up maybe 11% or so. So, roughly in line, despite the big lift. When do you think this stuff gets big enough that we start to see a little bit more separation -- a percentage point or two of outperformance?

David Ownby - *Regal Entertainment Group - EVP, CFO, and Treasurer*

Sure, Barton. We've talked in previous quarters about some of the industry dynamics that are out there. And even this particular quarter by our count, and by looking at the Rentrak data, the industry screen count is up about 0.5%. So if you kind of take the industry number and put it on a per-screen basis, the industry is probably up, call it, 10.8% or so, and we are up about 10.5% on a per-screen basis.

So as you say, roughly in line this quarter. And that's really with a -- still a pretty small number as you compare to our overall circuit of recliner screens. Amy talked about what that opportunity is going forward. But we are just not quite at a place yet where I would say we have a critical mass that's enough to move the number for the entire circuit.

You saw it closed the gap a lot for this particular quarter as compared to the last couple, and I think you'll continue to see some of that trend. But my gut is it will be late this year or early next before we really have a good critical mass of recliners to start really moving that number.

There is one other thing I will just point out to you, Barton. And I've hesitated to mention this because it really doesn't have a big impact going forward, but it has had an impact for the last couple of quarters. Remember that as we convert auditoriums to recliners, we have to temporarily close those auditoriums.

Last year in the second quarter, we were still ramping up this effort. And so on average, we had about 20 screens per day closed in the second quarter of last year. This year in the second quarter, we had an average of 90 screens closed per day for conversions. So, if you back those -- that



20 last year and that 90 this year -- out of our average screen count, and you rerun the math using the screens that were actually in operation, I think we were up -- that would've put us up about 11.5% per screen in box office revenue.

So again, now that we are at a full run rate for that effort, it won't really have a big impact going forward. We got to a full run rate about the end of the third quarter last year. But in the last couple of quarters, that has had a bit of an impact.

Barton Crockett - *FBR Capital Markets - Analyst*

That's interesting. So maybe there is a bit of underperformance on a comparable -- or outperformance on a comparable --?

David Ownby - *Regal Entertainment Group - EVP, CFO, and Treasurer*

Yes. Certainly, if we think about those screens that were closed -- and to be fair, not all screens are created equal, so that's you are doing average math there. But nonetheless, that gives you a better sense maybe of exactly where we are.

Barton Crockett - *FBR Capital Markets - Analyst*

Okay. Now switching gears a little bit, AMC, as I'm sure you know, is buying Starplex. So you mentioned about the acquisition environment. I was curious, was that a property where you guys even had an opportunity to be in the bidding? Or is there some reason why that wouldn't be appealing to you or you weren't even able to look at it?

Amy Miles - *Regal Entertainment Group - Chair of the Board and CEO*

Barton, I'll take that one. We did participate early on in the M&A process for Starplex, and we just ultimately decided to pass, due to the near-term and high return opportunities in our circuit -- and we've talked a lot about those today on the call. But I think looking to the future, we do continue to believe that our cash flow growth will include contributions from both acquisitions, as well as the return on some of the high-growth organic investments that we are making today.

Barton Crockett - *FBR Capital Markets - Analyst*

Okay. All right, that's great. Thanks a ton.

Amy Miles - *Regal Entertainment Group - Chair of the Board and CEO*

Thank you.

Operator

Chad Beynon, Macquarie.

Chad Beynon - *Macquarie Research Equities - Analyst*

Thanks for taking my questions. First one, kind of big picture, we all see the lineup for 2016, the tentpoles, et cetera. With your discussions with the studios, what's your sense on the overall number of products, big and small, that will come out in 2016 versus 2015? Just the number of units. Thanks.



Amy Miles - *Regal Entertainment Group - Chair of the Board and CEO*

Yes. I mean, I think if you look at it and you put it in perspective, we had about 141 films in 2010. And that's if you just consider the films released by, I would say, the major studios. And we expect that number to be relatively unchanged in 2015. It was in 2014. It was 136 films in 2014. So as we look forward to 2016 and 2017, based on the conversations that you've referred to with the studio partners, we would expect it to be very similar to the last five or six years.

Chad Beynon - *Macquarie Research Equities - Analyst*

Okay, thank you. And then just going back to the M&A question, on AMC's call, they kind of outlined a few key bullets in terms of what they are looking for in assets. Can you maybe go into two or three things that would make this a more attractive use of your capital versus going elsewhere in your circuit, as you mentioned earlier? Thanks.

David Ownby - *Regal Entertainment Group - EVP, CFO, and Treasurer*

Hey, Chad. I'll take that. I think as we said many times before, the first thing we are going to look for is a modern asset base, a quality modern asset base. And we are not particularly concerned with the geography, but we do want those theaters to be in stable or growing markets. We are not terribly concerned with what size those markets are, but we want them to be in stable or growing markets.

Obviously, today, as we look at potential acquisitions, we also want to think about the opportunity to include some of the customer amenities that we are installing in our own theaters, in those theaters as well. And so we'll think about asset bases that way, and we'll think about locations that way as well.

Ultimately, we are going to analyze those acquisitions on a free cash flow basis on whether or not they will be accretive to our free cash flow and our earnings. And I think as Amy mentioned before, we believe that, over the long run, if you give us a two or three-year horizon here, we think there will be plenty of those opportunities out there.

Chad Beynon - *Macquarie Research Equities - Analyst*

Okay. Thanks, David. And congrats on the results.

David Ownby - *Regal Entertainment Group - EVP, CFO, and Treasurer*

Thank you.

Amy Miles - *Regal Entertainment Group - Chair of the Board and CEO*

Thank you.

Operator

Leo Kulp, RBC.

Leo Kulp - RBC Capital Markets - Analyst

Thanks for taking the question. Just what -- other expense was -- it was a little bit higher than we expected. Can you talk about what sort of impact you are seeing on the -- from minimum wage increases in your various markets?

David Ownby - Regal Entertainment Group - EVP, CFO, and Treasurer

Sure, Leo. I'll be happy to do that. When you look at that increase in other OpEx, the drivers -- I think that number was up about \$11 million versus the same period last year. About half of that related to payroll. And you break that down -- that number down even further, some of that obviously was related to wage inflation in different markets around the country, and some of that was simply related to the fact that we had a lot more people coming through the building from an attendance perspective.

And we wanted to make sure that we could properly service those people, both at the box office and at the concession stand. So while that may, on the face of it, seem like a big increase in payroll for the quarter, I think when you look at the additional concession revenue and additional box office revenue that we got from that, you see pretty quickly that that's a -- that we are able to leverage those costs into an expanded margin.

So that's one factor. You asked specifically about the impact of minimum wages. And certainly there is some of that in these numbers in some of our markets. But that dynamic has really been going on for a number of years for us. And so, I don't think that environment, at least as it exists today, that impact is dramatically different than it's been for the last few years.

Leo Kulp - RBC Capital Markets - Analyst

Got it. Thanks, David. And you mentioned the strong concessions -- the concessions per cap growth. Is there any way you can sort of suss out how much of that concessions growth came from the sort of the composition of the box office, the really strong blockbuster slate versus sort of your underlying growth opportunities and pricing?

David Ownby - Regal Entertainment Group - EVP, CFO, and Treasurer

Yes. A lot of times when we talk about that concession per cap and we have a big difference in the film slate quarter-over-quarter, you can kind of see that impact in the concession per cap. This particular quarter, I mean, the top three films were all big action-type films. Last year, same dynamic in the second quarter. So I'm not sure the film slate had a really significant impact here on the performance in the per-cap.

If you break that \$0.40 increase down, what you would get is about \$0.10 of that relates to our new programs, our food and our alcoholic beverage programs; about \$0.15 of that relates to price increases; and about \$0.15 relates to volume increases on our core kind of Coke, popcorn, and candy items.

Leo Kulp - RBC Capital Markets - Analyst

Got it. Thank you very much. That's very helpful, David.

David Ownby - Regal Entertainment Group - EVP, CFO, and Treasurer

Thanks, Leo.

Operator

Matthew Harrigan, Wunderlich Securities.

Matthew Harrigan - *Wunderlich Securities, Inc. - Analyst*

Could you comment on what else you might do over time to improve the theatrical experience other than reclining seats? I mean, I think it's surprising just the level of receptivity. And it seems like it could tie into the attractiveness of alternative entertainment as well, although it feels like you could do some other things there to enhance the experience.

And then secondly, when you look at the box office rentals, Sony is having an absolutely wretched year. Relativity is about to go bye-bye. Is there anything that gives you pause in terms of just even more concentration on the box office generically among fewer studios and certainly among those top few films as you noted?

Amy Miles - *Regal Entertainment Group - Chair of the Board and CEO*

No -- I'll start with the last part of your question first, and then try to circle back. No -- I mean, with respect to comments on any one studio's performance from any one year, I think, over time, the major studios have had a very consistent contribution to film content. And we would expect that to continue in the future.

And what we also see in Open Road its films that need to find a way to a theatrical release. There's a lot of opportunities for those that invest in content to find distribution. So we are not concerned about that landscape changing dramatically over the next several years.

And from a customer amenity perspective, obviously to your point, we're spending a lot of time today focusing -- and I think on the amenities that are bringing the highest returns. And for us, that has been the reclining seats. But we are also continuing to expand our RPX footprint. And we're also looking at additional consumer enhancement in the concession stand. And that's going to continue.

Now, technology will continue to be a focus. We're going to continue to see how we can make it easier for a customer to get their ticket, communicate with them from a mobile perspective. And from a sight and sound perspective, we've seen improvements in laser and a lot of new ideas that are out there.

So I think there's a lot of exciting opportunities for customers visiting theaters over the next several years. And we'll just prioritize our investment in those amenities as it makes sense for our customers, and as it makes sense for our shareholders.

Matthew Harrigan - *Wunderlich Securities, Inc. - Analyst*

And I'm sorry, just one follow-up. Are there any subtleties I'm missing in your CapEx budget? Because frankly, I'm surprised it's not up more as you've quickened the pace on the luxury seating. It seems like you are keeping a tighter envelope than even some of your peers.

David Ownby - *Regal Entertainment Group - EVP, CFO, and Treasurer*

Yes, probably two things there, Matthew. One, I think our folks in our Real Estate department here have done a good job negotiating with our landlords, and making sure that we strike the appropriate deals. And fortunately, a lot of our landlords see the value in having a recliner theater in their center, and they've been willing to participate in some of those projects.

And just maybe from another perspective, as you think about our newbuild platform, that number is a little bit smaller for this year. That number will kind of come back to a little bit more normal as we go through the next two or three years. But we kind of shifted dollars away, at least in the interim period, from the newbuild program, to some of these higher-return recliner initiatives.



Matthew Harrigan - *Wunderlich Securities, Inc. - Analyst*

Great. Thanks, Amy. Thanks, David.

David Ownby - *Regal Entertainment Group - EVP, CFO, and Treasurer*

Thank you.

Operator

Tuna Amobi, S&P Capital.

Tuna Amobi - *S&P Capital IQ - Analyst*

So, David, you called out the contributions from premium screens, which I don't believe you've called out in a while. So I just wanted to understand better the underlying drivers of that, beyond obviously the major films that you mentioned.

Is there perhaps another explanation that might account for the impact that it had on the box office as well as ticket prices or, in other words, do you feel that you are kind of moving away from a stabilized state for those towards perhaps a new normal that will see higher contributions in the future?

David Ownby - *Regal Entertainment Group - EVP, CFO, and Treasurer*

Yes, Tuna, as you know, that premium number tends to bounce around a little bit quarter-to-quarter. It's been pretty stable on an annual basis over the last several years, call it kind of maybe 17% to 20% of the box office overall has been from a premium format.

To your point, this particular quarter was the highest one that we've seen, I believe, since the second quarter of 2012 from a premium perspective. I think, largely, that was just a function of the film slate, that there seem to be some films there that people really chose to see in a premium format. Both IMAX and 3-D were up -- and RPX, for that matter.

So I'm not sure I see anything there that's a trend. But when you combine the second quarter of this year with the first quarter -- which actually wasn't very good from a premium perspective -- I'm still not sure the annual number -- at this point, I would expect the annual number to be any different than it has been for the last few years.

Tuna Amobi - *S&P Capital IQ - Analyst*

Okay, that's very helpful. Two quick questions for Amy. So, first, Amy, from your earlier answer on the Paramount situation, it sounds like you are not philosophically opposed to this idea. It ultimately seems like it comes down to the economics of it.

So, do you envision that at some point the studios might be a little bit more amenable to providing you enhanced economics? And what other ideas do you have that could make the -- these types of arrangements more acceptable, maybe beyond ancillary revenues? Is there kind of a tipping point where you kind of feel like, okay, you are willing to kind of move forward with this?

And then separately, with regard to Open Road, right, it's been several years now since you launched. And I think it's fair to say, correct me if I'm wrong, that you had more success with that than one might have hoped at this point in its lifecycle.



So the question is, beyond obviously the initial vision of that project, how has that evolved? In other words, do you feel like you are at the point now where you might be able to take a little bit more risk, and perhaps explore incremental avenues to monetize that asset beyond the traditional way that you have monetized, especially in this age where content is in high demand across the board? So what other ideas do you feel like Open Road can provide you from a strategic perspective, given the success that it's had? Thank you.

David Ownby - *Regal Entertainment Group - EVP, CFO, and Treasurer*

Hey, Tuna, it's David. I'll take that Open Road question and then I'll let Amy follow-up with more discussion on the Paramount discussion. You know, we feel really good about where Open Road is. At this point, they are coming up on the four-year anniversary of their first film back in 2011.

Since then, in those -- that roughly four years, they've been able to generate about \$525 million of box office revenue. And in our view, they've done a good job of balancing finding films and, at the same time, staying within the risk parameters that we are comfortable with for that business.

At this point, it's probably a little bit too early to be thinking about a big change in course or a big expansion of their strategy. We like what they are doing. We want them to continue to do that and continue to grow. But I think that will be at a steady pace, as opposed to maybe taking giant steps forward with them, in the near-term anyway.

Amy Miles - *Regal Entertainment Group - Chair of the Board and CEO*

I guess, Tuna, to circle back with respect to your first question, I guess, first and foremost, what we would say is, we're not looking to change the existing theatrical model. We think the distribution model works. And some of the things that we hear today with respect to a more flexible model, some films may be -- should be treated different than other films, we think that exists today.

So, obviously from our perspective, we do require a minimum number of days or a minimum window for when we believe films should hit the home after the -- or I'm sorry -- from the theatrical release. But films are released today in the home with a myriad of viewing options. They are offered on several devices. They are offered with ownership or rental opportunities. They are offered at different price points. And some studios choose to strategically release films in the home in a manner where ownership opportunities may precede the rental.

And again, the length of time vary greatly film to film. So I already think there are a lot -- there is a lot of flexibility in the existing windowing system. And we felt if we moved forward on with the test that Paramount proposed, when we reviewed the film slate for the past several years, and applied the parameters of that test to what actually happened in the marketplace, several films would have had accelerated windows.

So, to your question of what we would think going forward, we've talked about economic protection, and we would just have to see some type of longer-term in nature agreement, and a structure that provided us more protection than has been proposed to us to date.

Tuna Amobi - *S&P Capital IQ - Analyst*

Okay. Well, that's very helpful. Thank you.

David Ownby - *Regal Entertainment Group - EVP, CFO, and Treasurer*

Thank you.

Operator

Jim Goss, Barrington Research.



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

Amy, you made some comments earlier that I felt were pretty interesting, and seeming to imply that the re-seating initiatives, the luxury recliners, and the food and beverage, and those sort of things were basically creating another level of the theatrical experience to the point that it might be similar to a couple of years ago, when the cost of growing digital might cause an increase in deal flow. Yet that didn't really happen at the time, as it were.

But I'm wondering if you are seeing sort of a stratification of the traditional theaters, the high-end, high-pick sort of theaters, and maybe now Regal and AMC and some others, moving into a different stage, so that maybe some of the smaller ones would feel the need to have a deal or maybe they wouldn't. But it would sort of create different levels of experience and just a different environment than we've been used to.

Amy Miles - *Regal Entertainment Group - Chair of the Board and CEO*

Yes, I think just going back to lead off, we do think ultimately that the conversion to digital did result in consolidation in the industry. So we use that just as an example of what happens when you have new CapEx cycles in the industry. So obviously, each circuit can decide whether or not they would like to invest in the luxury amenities to create their own opportunities.

But with that ahead of them, they may also just decide it's a good time to sell their circuit or divest of their assets, and let someone else take on that next capital cycle. So, over time in the industry, we have seen changes in capital cycles that have resulted in increased M&A activity. And we're just using that history as a predictor of the future here.

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

Okay. And do you have any timeframe over which you think this momentum might develop?

Amy Miles - *Regal Entertainment Group - Chair of the Board and CEO*

I think that's the harder part. When we talked about it before, we are going to be here for the long-term. And the way that we make business decisions are for the long-term. And if we were to try to say is that -- do we believe that could happen over the next two to three years? That answer would be yes.

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

Okay. And then one other thing. And somewhat along the lines of what Tuna was starting to bring up. To the extent that there might be a common good for the studios and the theaters in terms of home video sales, do you think there might be something to develop in terms of your, like, promoting eventual home video sales rather than give up a window earlier, and participate in the downstream? And then you are sort of rowing in the same direction a little bit?

Amy Miles - *Regal Entertainment Group - Chair of the Board and CEO*

Yes, and I would argue we do that today. We don't do it in a way that impacts the basic business model or the financial terms, but we have partnered with our studios, particularly with respect to the Crown Club, to try to figure out ways to help them market films that are released in the home.

And again, we do that because we think a healthy ecosystem makes sense for both of us. So, those type of marketing and partnering arrangements we have already pursued.

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

All right, thanks very much.

Amy Miles - *Regal Entertainment Group - Chair of the Board and CEO*

Thank you.

Operator

Jeff Logsdon, JBL Advisors.

Jeff Logsdon - *JBL Advisors - Analyst*

Amy, or David, if you could talk a little bit about DCIP? It's kind of the acronym that doesn't get discussed any more. And what's happening or could happen with virtual print fees and how DC/DC plays into all this, whether that just continues the payment pattern?

David Ownby - *Regal Entertainment Group - EVP, CFO, and Treasurer*

Hi, Jeff. You know, the reason we don't talk about DCIP, I think, very often is it's not particularly flashy, but it's done exactly what we intended for it to do. It initially funded the cost of digital. The studios are paying their VPS just as we planned. And, quite frankly, that the model that we set up initially were pretty much right on plan from that perspective. That will continue for a few more years until the -- until that debt has been fully paid off by DCIP.

So really not a whole lot to report there. It's just operating exactly as we thought it would.

Probably a similar discussion for DC/DC, although it's in an earlier point in its lifecycle. But again, I think that model is operating exactly as we thought it would. We are delivering content to the theaters digitally. And that economic model seems to be working exactly the way we thought it would.

So, those are easy discussions for us. Those are ventures that worked extremely well, although they are not particularly flashy, so they don't get a lot of attention from Wall Street, I guess.

Jeff Logsdon - *JBL Advisors - Analyst*

Thanks. Great quarter.

David Ownby - *Regal Entertainment Group - EVP, CFO, and Treasurer*

Thanks, Jeff.

Amy Miles - *Regal Entertainment Group - Chair of the Board and CEO*

Thank you.



Operator

There are no further questions at this time. I would like to turn the floor back over to management for closing comments.

Amy Miles - Regal Entertainment Group - Chair of the Board and CEO

Thank you for joining us this afternoon. And we look forward to speaking with you again at the close of our third quarter.

Operator

This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

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