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RUSSIAN FILM MARKET OVERVIEW. 2014 RESULTS

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The Economic Situation

The deterioration of the economic situation in Russia was already discernible in 2013, and a series of political decisions triggering sanctions against the country and retaliatory sanctions against the West, as well as the fall in oil prices in 2014, have further exacerbated the situation. The main blow of the crisis in the domestic economy, meanwhile, fell in December of last year, so the effects of that blow will be fully felt only in 2015 - as indicated in the forecast of the Russian Ministry of Economic Development (compiled in January 2015).

Changes in key economic indicators (as a % of the previous year)

Indicator	2008	2009	2010	2011	2012	2013	2014	2015 (MED forecast)
Gross domestic product	105,2	92,2	104,5	104,3	103,4	101,3	100,6	97,0
Export	134,6	63,7	132,1	131,3	102,4	99,2	94,3	67,6
Import	129,4	63,7	133,6	129,7	105,4	101,7	90,2	63,9
Industrial production index	100,6	89,3	107,3	105,0	103,4	100,4	101,7	98,4
Agricultural production index	110,8	101,4	88,7	123	95,2	106,2	103,7	101,1
Gross capital formation	109,9	84,3	106,0	110,8	106,8	99,8	97,5	86,3
Retail trade volume	103,7	94,9	106,4	107,1	106,3	103,9	102,5	91,8
Turnover in services	104,3	97,5	101,5	103,2	103,5	102,0	101,3	95,0
Inflation	114,1	111,7	106,9	108,4	106,6	106,5	111,4	112,2
Real disposable income	102,4	103,1	105,9	100,5	104,6	103,2	99,0	93,7
Overall unemployment (% of total workforce)	6,4	8,5	7,6	6,8	5,7	5,7	5,4	6,0
Average interest rate on six- month loans - Moscow Prime Offered Rate (%)	10,1	14,9	4,7	5,2	7,3	7,2	10,7	-
Average Brent Crude price (in USD)	98,7	62,8	80,3	110,7	111,4	108,3	99,5	-
Official dollar exchange rate at close of period (in rubles)	29,4	30,2	30,5	32,2	30,4	32,7	56,3	-

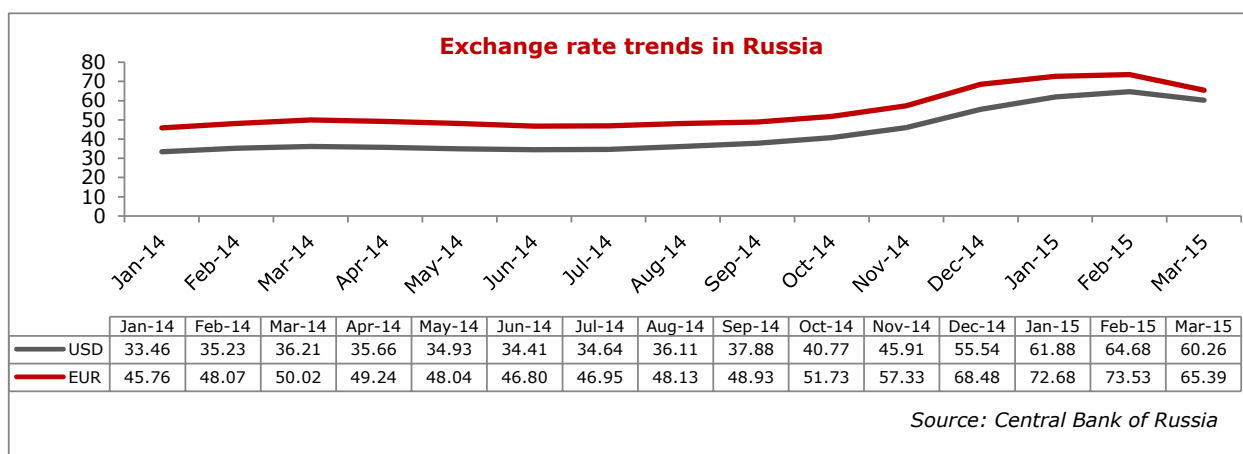
*Sources: Central Bank of Russia, Federal State Statistics Service,
Ministry of Economic Development (MED), IntercontinentalExchange*

Most serious for the film market is the decline in indicators such as the consumer price index and real disposable income (affecting cinema ticket prices and overall spending on leisure), the level of interest rates (influencing access to credit needed to build and/or modernize cinemas, film production, etc.), and also foreign exchange rates (suppressing purchasing of foreign goods, from digital projectors and servers to foreign films). The

majority of these critical indicators fell at the end of 2014/beginning of 2015 to a level lower than during the previous crisis (2008-2009), recalling the situation prior to the 1998 default.

In the first quarter of 2015, the effect of the sharp fall in the value of the Russian ruble, particularly in December/January, was felt in the Russian film market. It led to the postponement of the conclusive transition to digital projection in some cinema chains and in the Russian market in general (thanks to the sudden increase in the cost of equipment, many exhibitors were forced to postpone their plans to convert remaining analogue screens).

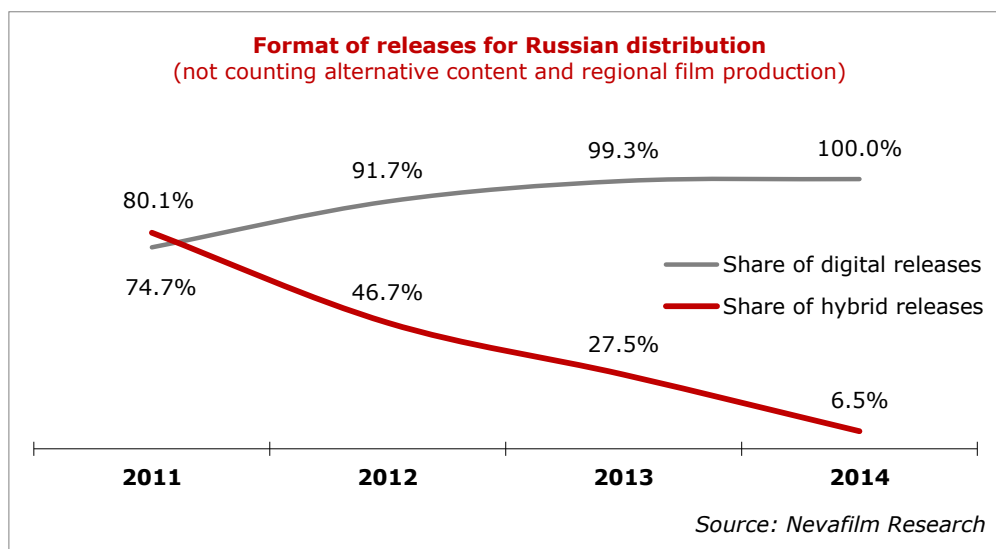
Another consequence was the reduction in the role of the Russian market in the international arena: box office revenue measured in foreign currency began to fall sharply, even though cinema attendance in CIS countries remained stable. According to the magazine Russian Film Business Today, which weekly converts box office revenue of each film currently on release into dollar equivalent, dollar revenue in the CIS (not including Ukraine) in 2014 amounted to \$1.246 billion - an 8.7% decrease from the previous year. In 2013, on the other hand, box office revenue in dollars rose 10% in comparison with 2012.



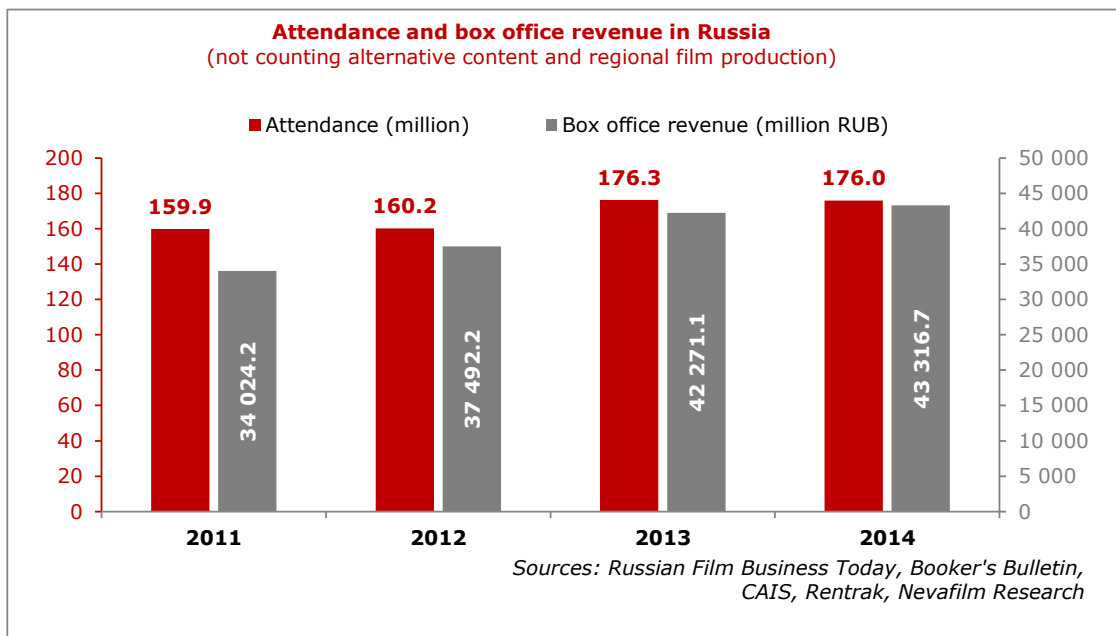
DISTRIBUTION

(not counting alternative content and regional film productions)

In 2014, 414 new releases went into distribution (in total 521 films were exhibited on the country's screens). In comparison with 2013, there were fewer new releases (429 in the previous year), but more films in distribution in total (491 in 2013). As we asserted in our six-month report on the state of the Russian film market, the effect of digital technology, which from 2007 had encouraged the expansion of Russian cinema programming, fizzled out. The number of hybrid releases fell last year to 6.5% (compared to 27.5% in 2013), while in 2014 there were absolutely no films released only on 35mm reel. Thus the share of releases for digital screens rose to 100%.



In 2014, we used four main sources for distribution statistics in the CIS and Russia: the magazines Russian Film Business Today and Booker's Bulletin, the Rentrak and Consolidated Automated Information System (CAIS) databases, and also raw data from a variety of distributors and cinemas. In our estimation¹, box office revenue from distribution in Russia in 2014 amounted to 43.3 billion rubles; the number of cinema tickets sold in the country was 176 million. The second half of the year, with the deteriorating geopolitical and economic situation, was worse than the first. In the period from January to June, the figures for attendance were better than 2013 for three months – January, February and June. From July to December, meanwhile, only one month (September) was better.



Annual growth in box office revenue was small (only 2.5%), and attendance at cinemas in fact fell, although within the bounds of statistical error, by 0.15%. On the other hand, the Russian film market expanded thanks to the joining of Crimea. According to our estimate, this region accounted for 0.51% of tickets sold in the country for Russian distributors (0.36% of box office). Thus, the actual level of cinema attendance decreased in Russia, from 2.07 times per year per person in 2013 to 2.03 in 2014 in population centres with commercial cinemas (from 1.23 to 1.21 in the whole country).

¹ In 2014, Russian box office revenue amounted to 93.6% of the CIS total, and attendance to 92.1% (based on weighted data for films from the distributors WDSSPR, Central Partnership, 20th Century Fox CIS, UPI, Karo, Volga and Bazelevs, NEVAFILM EMOTION).

Traditionally, the top ten major distributors account for 97% of box office and attendance.

Top 10 distributors in the CIS (not counting Ukraine)
(not counting alternative content and regional film productions)*

2014 place	2013 place	Company	Releases	Films	Screens	Attendance (mln.)	Box office (mln. rub.)	Attendance share	Box office share
1	3	20th Century Fox CIS	28	35	37 923	37,9	8 878,5	19,8%	19,1%
2	1	WDSSPR	22	34	22 995	35,2	8 399,3	18,4%	18,1%
3	4	Central Partnership	36	48	29 495	33,8	8 267,2	17,6%	17,8%
4	2	Karo Premiere/ Karoprokat	24	31	27 585	30,8	7 868,4	16,1%	17,0%
5	5	UPI	17	21	10 465	19,4	4 817,4	10,1%	10,4%
6	7	Bazelevs	3	8	6 982	7,7	1 814,8	4,0%	3,9%
7	8	Paradiz	26	29	14 139	5,6	1 412,6	2,9%	3,0%
8	9	Volga	11	17	7 054	5,6	1 264,7	2,9%	2,7%
9	6	Nashe Kino	28	40	9 576	5,4	1 217,2	2,8%	2,6%
10	10	West	18	20	8 151	4,6	1 099,4	2,4%	2,4%

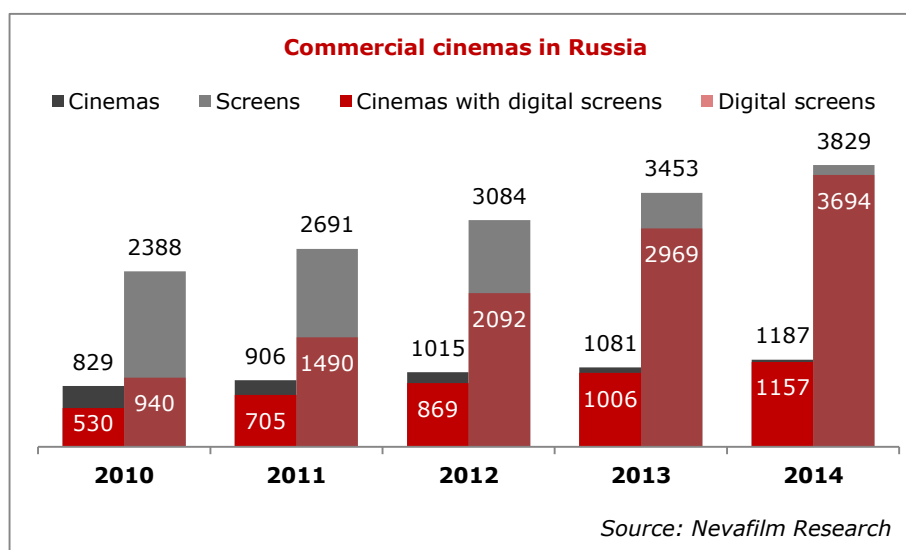
*when films are distributed by two companies, distribution results are accredited in full to each company

Sources: Russian Film Business Today, Booker's Bulletin, CAIS, Rentrak, Nevafilm Research

In total there are 44 companies active in the market, not counting those that specialize in alternative content and producers of local films. It is to be noted that the number of distributors slightly decreased last year: in 2013, there were 47. This is further corroboration of the end of the "digitalization effect": in 2010, the switch to digital projection technology lower the barrier of entry to the film distribution market, and the number of distribution companies grew from 30-35 to 40 and over, now the number is again decreasing.

EXHIBITION

According to data for 1 January 2015, Russia has 3829 commercial cinema screens in 1187 cinemas (on average, 3.2 screens per site). The transfer to digital cinema projection was practically completed last year: in 96% of commercial Russian cinema screens were fitted with digital equipment (3694 screens). There are 37 IMAX cinemas, 30 screens with motion effects (20 D-Box and 10 4DX), and also 61 screens with premium audio formats (49 Dolby Atmos and 12 Barco Auro).



The number of cinemas where every screen has a digital projector reached 1084 (91% of the total number of cinemas). However, on 1 January 2015, there were still theatres working only with film – they amounted to 2.5% of the total (30 cinemas with 34 screens). Unable to screen new releases in digital format, these cinemas continue to screen movies released on film in 2013 and early 2014 and movies from film fund archives. We have not counted screens that have switched to e-cinema projection equipment.

At the end of 2014, the leaders on the Russian market remained Cinema Park, Formula Kino and KARO. Each of these chains has more than 200 screens and accounts for more than 5% of the total market. Of the ten largest exhibitors, only two have not been fully digitalized – the regional Premier-Zal and Monitor, which work with some cinemas through repertoire planning agreements, still had screens with analogue projectors on 1 January 2015.

Leading operators of cinema chains in Russia on 01.01.2015

(including franchises and cinemas using repertoire planning)

Place on 01.01.2015	Place on 01.01.2014	Operator	No. of cinemas	No. of screens	No. of cinemas with digital screens	No. of digital screens	Share of cinemas with digital screens	Share of digital screens	Market share by number of screens	Head office
1	1	Cinema Park	30	280	30	280	100%	100%	7.3%	Moscow
2	2	Formula Kino	34	253	34	253	100%	100%	6.6%	Moscow
3	3	Karo	30	221	30	221	100%	100%	5.8%	Moscow
4	4	Kinomax	29	190	29	190	100%	100%	5.0%	Moscow
5	6	Premier-Zal	105	158	105	156	100%	99%	4.1%	Yekaterinburg
6	5	Luxor	22	152	22	152	100%	100%	4.0%	Moscow
7	7	Cinema Star	21	109	21	109	100%	100%	2.8%	Moscow
8	8	Monitor	26	98	26	96	100%	98%	2.6%	Krasnodar
9	11	Mirage Cinema	14	95	14	95	100%	100%	2.5%	St Petersburg
10	10	Pyat' Zvevd	11	66	11	66	100%	100%	1.7%	Moscow
Total for these operators			322	1,622	322	1,618	100%	100%	42.4%	
Total in Russia			1,187	3,829	1,157	3,694	97%	96%	100.0%	

Source: Nevafilm Research

The market leaders in terms of tickets sold in 2014 were Cinema Park, Formula Kino and Kinomax (including cinemas working with operators through franchising agreements). They attracted 23.2% of the annual audience in the country. The concentration ratio for exhibitors continues to decrease with the diminishing effect of the two major recent mergers (Cinema Park with KinoStar de Lux in 2011, and Formula Kino with Kronverk Cinema in 2012). On the whole, the exhibition market in Russia is much less monopolized than distribution. Here, the concentration ratio in terms of box office revenue for the three market leaders in 2014 amounted to 59%.

Among the Russian regions, Moscow is the leader, with 18% of commercial cinemas in the city. The new territory of the Crimean Federal District accounts for only 0.8% of cinema screens in Russia.

Distribution of commercial cinemas by Federal District in Russia on 01.01.2015

Federal District	No. of cinemas	No. of screens	No. of cinemas with digital screens	No. of digital screens	Market share by no. of screens
Greater Moscow	128	688	126	676	18,0%
Volga FD	178	631	172	594	16,5%
Central FD (without Greater Moscow)	196	562	186	538	14,7%
Siberian FD	154	430	150	412	11,2%
Ural FD	127	367	124	353	9,6%
Southern FD	120	344	119	330	9,0%
St Petersburg	60	344	58	336	9,0%
Northwestern FD (without St Petersburg)	87	200	86	194	5,2%
Far Eastern FD	86	151	85	150	3,9%
North Caucasian FD	36	80	36	79	2,1%
Crimean FD	15	32	15	32	0,8%
Total in Russia	1187	3829	1157	3694	100%

Source: Nevafilm Research

DEVELOPMENT TRENDS IN THE RUSSIAN CINEMA MARKET

- The digital revolution in worldwide cinema has made it possible to release film on cinema screens with lower outlay, and has facilitated an increase in the number of independent players on the Russian market, experimenting both with widescale and specialist releases. However, by 2014, the opportunities for expansion in Russian cinema programming and growth in distribution due to digital technology had been exhausted. It has become clear that the time for experimentation has finished, and moreover, for some of the oldest and strongest independent distributors, it has proved unsuccessful. Profits from quality independent and art-house cinema in Russia have become unattainable due to the reduction in purchasing and decrease in prices from network television channels. The number of Russian cinemas working with "difficult" films has not increased, and Internet sales are yet to pay their way due to the high level of video piracy. These and similar problems will result in the further decline in the number of distributors and further consolidation of the Russian market.
- In recent times, the number of Russian citizens in the most active age group for cinema attendance (15-24 years old) has decreased, and attendance both for the most popular films and for each film on average has begun to fall. It is obvious that the explosive growth of previous years will not repeat itself. In expectation of the now-grown-up audience that filled cinemas in the 2000s and should now be returning with their children, distributors expanded their offering of family and children's films in 2014. So far, however, this policy has not paid off. Nonetheless, the trend for developing offerings for children continues in 2015 - there are more and more new projects showing cartoon anthologies in morning and afternoon screenings. These offerings from distributors are also supported by the opening of special children's screens by exhibitors (this type of offering has been pioneered by Formula Kino in Moscow).
- Towns with population less than 100,000 remain the main potential target for expansion of the cinema network. More than 70% of the population in such towns do not have access to cinema exhibition services. However, investment in construction of cinemas in these areas remains low-return. Although plans for such chain cinemas continue to appear in Russia, so far the only successful attempts have been the refitting of Houses of Culture with regional government funds (in Krasnodar Krai and Tula Oblast, for example). Thanks to regional and federal government spending, this trend will continue in 2015-2016.
- Due to the high risks and low volumes in underdeveloped markets, cinema chains over the last two years have preferred to expand in the capital cities, where incomes are higher and cinema attendance is more widespread. In 2013-2014, the greatest number of multi-screen theaters in retail and entertainment centres opened in St Petersburg and Moscow. According to plans already announced by developers, this trend will continue in the crisis years of 2015-2016.
- As a result of oversaturation in the market in Russia's major cities, average attendance and revenue for each screen is falling. In 2014, these indicators reached

48,800 and 12 million rubles, lower by 11% and 8.6% respectively. What is interesting, however, is that the average revenue for each seat in Russia, although it fell by 4.8% in 2014, remains now at the same level as in 2011. In 2012-2013, this figure increased in Russia. These fluctuations can be explained by the more stable (in comparison with the fall in attendance per screen) decrease in the average number of seats per screen (roughly 4% annually. In 2011 it amounted to 185, and last year to 163).

- Participants in competitive markets are experiencing an outflow of audiences from their screens, and try to attract their attention by offering new and interesting screening concepts. Thus in 2014, the first megaplexes (theaters with 16 or more screens) appeared in Russia, the VIP sector of cinema services was actively expanded (especially in Moscow and St Petersburg), and there has been an increase in novelty presentation systems ("supersound" and motion enhancement), ticket prices for which are usually higher. This also demonstrates exhibitors' hopes of drawing a wealthier audience into theaters. Equally, this shows theaters' efforts to attract an older public in light of the contraction in the younger population.
- Meanwhile, the crisis that hit Russian exhibitors in November-December is likely to bring an end to the trend of focusing on wealthier consumers. For now, the first noticeable consequence of the crisis has been the postponement of the full transition to digital projection in the country (due to the sudden rise in equipment costs). More important, however, is the fall in revenue from cinema auxiliary activities including advertising revenues (this area always reacts quickly and sharply to any crisis) and profits from cinema bars (costs of imported supplies have risen faster than end-user prices can be raised). At the same time, the fear that cinemas might suffer from increased rents set in foreign currency has proved groundless. The majority of Russian exhibitors either own their own premises, or have long since transferred rental agreements into rubles (after the crisis of 2008-2009). Others have managed to resolve the issue with landlords by moving to payment of a percentage of revenue, settlement in rubles or the establishment of an exchange rate band. These solutions to rental issues were facilitated by a joint open letter from the major cinema chains to retail center management companies announcing a moratorium on occupying premises that have fallen open due to high rental rates.
- In light of the developing crisis and longterm factors that have reduced the opportunities for expansion and increased the need for cinema owners and managers to focus on cutting costs, many exhibitors have begun to make changes to their staffing policies. First and foremost, redundancies affect line personnel in cinemas. However, this is also the result of the longterm trend for automation of management processes in cinemas.