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CNK - Q4 2017 Cinemark Holdings Inc Earnings Call

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PRESENTATION

Operator

Good morning. My name is Christie, and I will be your conference operator today. At this time, I would like to welcome everyone to the Cinemark's Fourth Quarter and Full Year 2017 Earnings Call. (Operator Instructions)

Ms. Chanda Brashears, Vice President of Investor Relations, you may begin your conference.

Chanda E. Brashears - Cinemark Holdings, Inc. - VP of IR

Thank you, Christie, and good morning, everyone. At this time, I would like to welcome you to Cinemark Holdings Inc.'s Fourth Quarter and Full Year 2017 Earnings Release Conference Call hosted by Mark Zoradi, Chief Executive Officer; and Sean Gamble, Chief Financial Officer.

In accordance with the safe harbor provision of the Private Securities Litigation Reform Act of 1995, certain matters discussed by members of management during this call may constitute forward-looking statements. Such statements are subject to risks, uncertainties and other factors that may cause Cinemark's actual performance to be materially different from the performance indicated or implied by such statements. Such risk factors are set forth in the company's SEC filings. The company undertakes no obligation to publicly update or revise any forward-looking statements.

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, within the company's annual filing on Form 10-K and on the company's website at investors.cinemark.com.

I would now like to turn the call over to Mark Zoradi.



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Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Thank you, Chanda, and good morning, everyone. We appreciate you joining us to discuss our 2017 fourth quarter and full year results. I will focus on the full year results, and Sean will address our quarterly results in his prepared remarks.

Before I get into our financial results, I'd like to kick things off by announcing a 10% increase to our dividend, or \$0.12 per annum. This is our third consecutive increase over the past 3 years and represents growth of 28% during that time frame. In light of the benefits we will receive from the U.S. tax reform, as well as our management team's and board's ongoing confidence in our industry and strength of Cinemark's financials, we felt this move was appropriate action to further reward shareholders and in line with our balanced capital allocation strategy.

On the heels of our record-breaking performance in both 2015 and '16, we're thrilled to report our third consecutive year of all-time highs across our global platform, including records in each of our revenue categories, totaling approximately \$3 billion, net income of \$264 million, adjusted EBITDA of \$724 million and adjusted EBITDA margin of 24.2%. We believe it's even more noteworthy that we achieved these record financial results in an industry box office environment that was slightly down year-over-year.

Shifting attention for a moment to our industry. While the North American box office declined 2.5%, 2017 followed 2 consecutive years of record results. And despite the challenging benchmark, 2017 still delivered numerous industry record achievements, including the highest-grossing first quarter and first half of year of all time, 4 records in the months of March, April, September and December. Furthermore, 2017 was the third consecutive year to exceed \$11 billion of industry box office.

Theatrical exhibition remains a stable and profitable industry, with attendance that hovers between 1.2 billion and 1.3 billion patrons per year, with periodic ebbs and flows driven by the quality, volume, timing and mix of film content. As we look forward, we remain optimistic about the 2018 film slate, especially following the gigantic release of Black Panther, which scored the biggest Marvel opening in history, with a box office of approximately \$290 million in its first week. Even more impressive, it achieved this record during a nonpeak release period.

Also, on the horizon for 2018 is Avengers: Infinity War; Jurassic World: Fallen Kingdom; Solo: A Star Wars Story; The Incredibles 2; Deadpool 2, Dr. Seuss' the Grinch; and the sequel to Wreck-It Ralph, just to name a few. And beyond 2018, we're already enthusiastic about the 2019 film slate with the visibility that we have to date. It's gearing up to be another sensational year with another Star Wars; another Avengers; the sequel to Frozen, which was the highest-grossing animation of all time; a live-action Lion King; and Wicked, an on-screen adaptation of one of the most successful Broadway plays in history.

Now shifting back to Cinemark's results. Our domestic operations over-indexed the North American industry office -- box office by 90 basis points for the full year, and that was achieved with an average of 148 screens closed per day over the course of the year that were undergoing recliner conversion. This now marks 8 of the past 9 years of industry outperformance and is another example of our consistent financial performance.

Internationally, our Latin American team also had a strong year. Despite challenging headwinds from the reduced animated content volume and local product strength, our international admission revenues grew by nearly 7%. This reinforces that even in the midst of an economic downturn, people still want to go to the movies, as it remains a favorite and affordably priced, out-of-home entertainment option for millions of people. The exhibition industry is more closely tied to film content rather than economic cycles, as we've experienced time and time again in our 25 years of operating in Latin America.

Our strong global results are the by-product of consistent operational excellence, disciplined investment, prudent decision-making and consumer-minded growth initiatives. As we kick off a new year, our strategic objectives remain largely in line with 2017, and we're focused on creating an extraordinary guest experience to grow attendance, investing in and growing our AAA circuit and sustaining our consistent industry-leading results.

The ongoing initiatives that we will pursue to achieve these objectives in 2018 include: continuing to enhance our guest amenities, with particular emphasis on luxury recliner -- Luxury Lounger recliner seats, expanded food and beverage offerings and premium technology formats, growing our loyalty and membership programs and targeting organic growth and accretive M&A.



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Let's start with guest amenities. Recliner seats remain our #1 sought-after guest amenity, and they continue to generate ROIs that significantly exceed our 20% threshold. In light of success we've had with recliners, we were aggressive with this initiative in 2017. We exceeded our initial estimate of reaching 40% of our domestic circuit. And as a result of our team's tireless efforts, we managed to recline 964 screens in 2017, essentially doubling our Luxury Lounger footprint during the year, which brings our year-end recliner screen count to over 2,000 or 45% of our domestic circuit.

Because the results to date have been so positive, we believe there is continued opportunity in 2018 and expect to end the year with approximately 55% of our domestic circuit featuring this luxury amenity. As always, we will do this with a balanced and disciplined investment approach, pursuing this initiative to the extent we see a sustained ability to generate returns above our 20% ROI threshold.

Enhanced food and beverage offerings also continue to score big points with our consumers, leading to an enriched guest experience and overall financial growth. We now offer expanded food and beverage options in 56% of our domestic circuit, including alcohol in 31% of our footprint. In 2017, new products, combined with our focus on sustained growth of core concessions, such as soft drink, popcorn and candy, generated nearly \$50 million in incremental food and beverage revenue growth and drove an exceptional 8.7% increase in our worldwide food and beverage per caps.

Over the course of 2018, our food and beverage team will continue to drive a wide range of product-based promotional and distribution-related initiatives to maintain this growth trend, which has now extended over 11 consecutive years. One action we recently concluded to help do so is the formation of a new strategic partnership with Pizza Hut that will enable Cinemark to make and sell select Pizza Hut products using their fresh, high-quality ingredients. We're excited to bring this well-recognized and highly regarded brand into our theaters and work together to further strengthen and diversify the products we offer our guests.

Moving on to technology. We're already the #1 private label premium large format in the world with our 242 XD-branded screens, and we're working diligently to further expand our PLF market share. As a result of our circuit wide XD marketing campaigns and promotions that we executed throughout 2017, and coupled with the benefit of Luxury Lounger seats that we've been adding to these auditoriums, we achieved an all-time XD results, generating 8.6% of our worldwide box office on just 4.1% of our screens. During 2018, we'll continue to update, enhance and extend the promotion of our XD brand as we seek to continue building on its success.

Another element of premium technology that we're introducing into our circuit is virtual reality. On last quarter's earning call, we announced our affiliation with The Void and plans to open our first virtual reality experience in our flagship West Plano theater this summer. Notably, our theater will be only the fourth commercial U.S. installation of The Void experience to date, following Times Square in New York, downtown Disney in California and Disney Springs in Florida.

We're excited about our partnership with The Void and are eager to offer our guests their most recent hyperreality experience of Star Wars: Secret Of The Empire that was created in collaboration with Industrial Light & Magic's xLab. I've experienced this firsthand, and believe me, the force is strong with this one.

Another initiative we're working on to enhance guest experience is loyalty. Our worldwide loyalty programs continue to grow steadily and pay dividends, with more than 7.5 million loyalty members. Our domestic program connections was launched 2 years ago and is comprised of our most active moviegoers who attend most frequently. Our data suggests 50% more than our average moviegoer. They also spend more on food and beverage, and have a heightened volume of premium-format ticket purchases.

The customer data we collect provides the ability to analyze purchase habits and understand the why in this behavior. This enables us to target our marketing message and communication channels more effectively with personalized promotions and incentives to drive attendance and brand loyalty. Our advanced data analytics team now works hand in hand with the marketing team, and has become part of our DNA to drive continuous improvements throughout our loyalty, digital and social media initiatives. Expect more evolution and emphasis on connections, and all our loyalty marketing efforts in the coming months and years.



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Now shifting to an update on Cinemark's Movie Club. As a reminder, Movie Club is our recently launched domestic membership program that aims to drive brand loyalty and guest satisfaction while growing attendance and securing market share. In less than 12 weeks, 80 days to be exact, we have signed up over 120,000 members, far exceeding our initial launch goal. This equates to an average of over 350 members per Cinemark theater location.

Already, Cinemark's Movie Club members represent nearly 2% of our domestic ticket sales. Notably, nearly 1/3 of Movie Club members were not previously a part of our Connections programs, which suggests we're signing up and getting to know an even broader movie-going audience. Each member is paying us a reoccurring \$9 per month for each movie ticket credit. Members are highly engaged, with 58% of the accumulated movie credits already used and the remaining credits rolling over to the next month, a standout feature that consumers love.

The consumer response to Movie Club has been overwhelmingly positive, particularly regarding the benefits and features of our program, such as: no online fees, a benefit that's especially appealing to the millennial audience; 20% discount on concessions, everyone loves that; and the ability to reserve seats in advance, upgrade to a premium format and bring a companion for the same Movie Club price. We've also received incredible guest feedback that our program is not a "use it or lose it" proposition and that it's directly associated with an established brand that they know and trust. Additionally, our program's ease of use and top-notch customer service have been receiving rave reviews.

We're most pleased with these early launch results, our guest response and the ability for detailed data accumulation and the significant growth opportunities for Movie Club. We're excited about the many consumer benefits and marketing opportunities in front of us as we continue to grow and develop our program for the long term in a financially prudent and sustainable way.

And finally, some comments on organic growth and accretive M&A. During 2017, we added 92 screens worldwide, expanded our footprint to just under 6,000 screens spanning 16 countries throughout the Americas. In 2018, we expect heightened opportunities in the U.S. of approximately 1% to 2%, incremental screen growth and another 5% to 6% in South and Central America. Additionally, we'll continue to target accretive M&A, both domestically and internationally, with our balanced and disciplined investment criteria. Consistent with our prior messaging, we'll concentrate on expanding further in our key markets and will prudently evaluate all M&A opportunities that arise.

In conclusion, consistency and stability are the cornerstones of our message and are represented through our financial discipline, our operational excellence and strategic execution. This consistency in how we operate our business results in stability of our financial performance, including over-indexing the industry and adjusted EBITDA margin in excess of 20% in both healthy and challenging box office environments. We commend our entire worldwide team for the discipline and execution required to deliver our consistent performance.

One last thing before I turn the call over to Sean. I'd be remiss if I did not acknowledge and publicly congratulate Sean on his recently announced promotion to Chief Operating Officer. As stated in our press release, Sean will continue his roles and responsibilities as CFO, including Investor Relations, but will also be taking on increased leadership of film, purchasing and business development.

I can't say enough about what an incredible partner he has been in leading all aspects of this company since I joined 2.5 years ago. His strategic vision, process improvement expertise, innovative spirit, forward thinking have been tremendous assets to Cinemark, and we're pleased to acknowledge his accomplishments with this promotion.

That concludes my prepared remarks, and I'll now turn the call over to Sean to address a more detailed discussion of our financial performance. Sean?

Sean Gamble - *Cinemark Holdings, Inc. - CFO & COO*

Thank you for the very kind words, Mark. Good morning, everyone. In addition to the records Mark just highlighted for the full year 2017, we also delivered record fourth quarter results in all of our worldwide revenue line items, average ticket price, food and beverage per caps, adjusted EBITDA and adjusted EBITDA margin, which tied our previous fourth quarter records set in 2014. More specifically, total worldwide revenues grew 7% year-over-year to a fourth quarter high of \$750 million. Our consolidated adjusted EBITDA was \$187.5 million and our adjusted EBITDA margin was 25%.

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Domestically, admissions revenues increased 3.5% to \$353.4 million and exceeded North American industry growth by 50 basis points, marking 32 out of the past 36 quarters of outperformance. Our U.S. attendance of 44.3 million patrons declined slightly year-over-year, but was more than offset by average ticket price growth of 4.3% to \$7.98 that benefited from the impact of recliners, new builds and ticket type mix.

Domestic concessions revenues grew 9.8% during 4Q and reached an all-time quarterly high of \$207.9 million. Similarly, our concessions per patron also achieved an all-time record of \$4.69, increasing 10.6% as a result of strategic pricing and the varied food and beverage initiatives Mark previously discussed. We've now extended our domestic per cap growth trend to 44 consecutive quarters, the longest trend amongst our peers.

Other revenues also grew 6.5% to \$21.3 million, driven primarily by screen advertising and promotional income. Overall, our U.S. operations set fourth quarter highs in total revenues of \$582.6 million, adjusted EBITDA of \$155.3 million and adjusted EBITDA margin of 26.7%.

Internationally, overall attendance increased 3.8% in the fourth quarter, driven by new screen additions throughout the year. Attendance related to local product was down 46% versus prior year as a result of a challenging benchmark set by last year's success of *My Mother (sic) [Mom]* is a Character 2 in Brazil. However, that drop was offset by Hollywood's stronger lineup of action films that translated better to Latin American audiences than 4Q 16's heavier volume of sci-fi-oriented content.

International admissions revenues were \$90.1 million, which were up 8.4% versus last year as reported and up 8.7% in constant currency. Our as-reported average ticket price of \$4.15 translated to a constant-currency increase of 4.5%. This increase was driven by inflationary price growth and an uptick in 3D and premium large-format mix.

International concessions revenues set a fourth quarter record at \$53.3 million, which increased 11% as reported and 11.3% in constant currency. Furthermore, our as-reported international concessions per patron reached an all-time high of \$2.46, which translated to a 7% increase in constant currency.

International other revenues also had a strong quarter and grew 25% to \$24 million due to increases in screen advertising and promotional income. Overall, total international revenues grew 11.4% to \$167.4 million as reported, with an adjusted EBITDA of \$32.2 million and an adjusted EBITDA margin of 19.3%.

The impact of foreign currency translation was fairly neutral for the quarter and wound up delivering an approximate 2.5% favorable impact for the full year, following multiple years of headwinds. That said, if current rates continue to hold, we would expect to return to a low to mid-single-digit percentage drag in 2018. As a reminder, the vast majority of our international operating expenses are transacted in local currency, including film rental and facility lease expenses, so the impact of currency exchange is predominately translation-based and not transaction-oriented.

Shifting back to our worldwide consolidated results, fourth quarter film rental and advertising costs as a percentage of admissions revenues increased slightly to 54.3%. This increase was driven primarily by a range of marketing initiatives that focused on XD, our global loyalty programs, the launch of Movie Club and building awareness for the significant number of domestic recliner conversions we completed in the quarter.

Concessions costs, as a percentage of total concessions revenues, increased by 40 basis points in comparison to the prior year. This increase was driven by the impact of expanded food and beverage offerings across our domestic circuit. As mentioned on prior calls, while these offerings tend to create a slight drag on our concessions margin rate, they continue to drive sizable growth in our overall concessions revenues and income.

Salaries and wages were 12.4% of total revenue and increased 70 basis points compared to the fourth quarter of 2016. This increase was primarily due to the year-over-year impact of closed screens for recliner conversions, ramp-up timing of new theaters, increased support of our food and beverage initiatives and the impact of global minimum wage hikes. Conversely, facility lease expenses and utilities and other costs as a percentage of total revenue declined by 70 basis points and 180 basis points, respectively. These decreases benefited from the predominantly fixed nature of these costs relative to revenue growth generated during the quarter.

And G&A for the fourth quarter increased by 50 basis points as a percentage of total revenue, primarily due to certain nonrecurring items as well as investments in varied food, varied growth and productivity initiatives.



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Collectively, fourth quarter pretax income was \$76.4 million compared to \$75.1 million in 4Q of the prior year. Our fourth quarter's effective tax rate was negative 25%, and net income attributable to Cinemark Holdings, Inc. was \$95.1 million or \$0.82 per diluted share.

We'd like to highlight that year-over-year comparisons of net income and earnings per share for the fourth quarter and total year were both favorably impacted by a \$45 million credit to tax expense in the quarter that was driven by U.S. federal tax reform. As we look forward, we expect tax reform will reduce our worldwide effective tax rate to somewhere in the mid- to high 20% range. Please note that our 2017 calculations related to tax reform were provisional, and true-up adjustments to those calculations may affect our 2018 rate.

With respect to our balance sheet, we ended the quarter with a cash balance of \$522.5 million and a net debt position of \$1.5 billion. We remain dedicated to prudent capital planning, including taking advantage of favorability in the debt markets when opportunities present themselves. In addition to the third repricing of our term loan that we communicated earlier this year, during the fourth quarter, we extended our undrawn revolving credit facility by 5 years, while improving the terms of facility.

Turning attention now to our U.S. footprint. We operated 339 theaters and 4,561 screens in 41 states and 102 DMAs at quarter end. During the quarter, we built 1 new theater with 8 screens and closed 1 theater with 9 screens that was at the end of its lease term. We had signed commitments to open 7 theaters and 72 screens during 2018 and 6 theaters representing 64 screens subsequent to 2018. We expect to spend approximately \$98 million in CapEx for these 136 screens.

Internationally, our Latin America circuit grew to 194 theaters and 1,398 screens across 15 countries. During the quarter, we expanded by 3 screens. As of quarter-end, we had signed commitments to open 10 new theaters and 55 screens during 2018, and 1 theater representing 6 screens subsequent to 2018. We anticipate spending approximately \$41 million in CapEx for these 61 screens. We continue to view Latin America as a long-term growth opportunity, and we anticipate adding 50 to 75 international screens per year in the near term.

Regarding overall CapEx, we spent \$118.1 million in the fourth quarter, including \$18.7 million on new builds and \$99.4 million on existing theaters. During last quarter's earnings call, we indicated that full year CapEx for 2017 might exceed our previously stated guidance as a result of opportunistically accelerating a number of recliner conversions. Total year CapEx was \$380.9 million and did somewhat exceed that guidance due to the advancement of these accretive projects.

We continue to view Luxury Lounger and other ROI-generating amenities that enrich the guest experience as prudent uses of capital. Early last year, we stated that 2017 would likely be our peak year of CapEx due to recliners, and we reiterate that message today. That said, we do expect 2018 CapEx to remain elevated as we actively pursue the strategic initiatives that Mark described, including an increase in domestic new builds.

As such, we anticipate spending approximately \$350 million during the year, of which \$120 million is designated for new builds, both domestically and internationally; \$80 million is for core maintenance of existing screens and in line with our historic run rate; approximately \$10 million is associated with completing the renovation of our headquarters building; and the residual \$140 million is for cash flow-generating projects that include additional Luxury Lounger theater conversions and varied food and beverage initiatives. We expect that our annual depreciation and amortization will increase to approximately \$260 million to \$270 million as a result of our 2017 and 2018 capital expenditures.

Lastly, I would like to briefly address the impact of the new revenue recognition accounting standard that we adopted beginning January 1, 2018. We do not believe the adoption of this new pronouncement will have a material effect on our overall financial results. However, we do expect it to impact how we recognize revenue for certain items, which are detailed in our 10-K disclosures.

In summary, other revenues will increase due to the inclusion of a significant financing component related to our NCM deferred revenue as well as a change in the amortization method used for such deferred revenue. In addition, transaction fees will now be recorded on a gross-versus-net basis.

Finally, we expect a slight impact on admissions and concessions revenues resulting from a deferral associated with points issued to our Connections loyalty members when purchases are made. We will provide additional specifics related to the impact of these changes during our 2018 first quarter earnings call.



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In closing, successful execution of our strategic initiatives and long-term growth investments, coupled with our disciplined capital allocation approach, delivered our third consecutive year of record-setting results. We are pleased to be able to further enhance shareholder value with our most recent dividend increase and do so in the midst of our peak investment cycle, while maintaining the strength of our balance sheet as a result of the consistency of our financial strength and benefits derived from U.S. tax reform.

Christie, that concludes our prepared remarks, and we would now like to open up the lines for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Mike Ng with Goldman Sachs.

Michael Ng - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Great. My first question is just on the U.S. concession per cap growth, which I think was the fastest on record. Could you help us unpack that a little bit more and give us a few details about the strategic pricing you mentioned in your prepared remarks? When did you start implementing those price increases, and was there any benefit in the quarter from the initial rollout of tax on top?

Sean Gamble - *Cinemark Holdings, Inc. - CFO & COO*

Sure. Happy to do so. I would say the biggest driver of the increase is really the varied initiatives that we've been pursuing to stimulate incremental incidence. That represents about half of the growth. In addition to that, the pricing, that's something that we kind of do on an active basis. We're constantly kind of looking at our price sensitivity and opportunities to either increase or decrease price, depending on what makes most sense, to drive further incidence. That said, overall price probably drove about 35% of the increase you're seeing in the quarter. The remainder is coming from new builds and certain other factors. As we're adding new builds to our circuit, they tend to carry a slightly higher percentage -- or slightly higher overall pricing component just based on the concessions that we're putting into those new builds. Tax on top was, I would say, something that was embedded in there but wouldn't have had a material effect at this point.

Michael Ng - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Okay. And this is a question about Cinemark's geographical footprint. But can you talk a little bit about how Star Wars performed in Cinemark's markets and whether or not you under-indexed or over-indexed in that film? And similarly, is there any early read that you can share about how Black Panther is performing in Cinemark's markets?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Let me take the second question first. Regarding Black Panther, Black Panther has been extremely positive for us, both domestically and internationally, with many records on -- throughout our circuit, with the highest weekend or week that we've had ever in many, many of our theaters. It's not -- that's not surprising in the United States, how well we did, but we're equally happy with how we did in Latin America. Take, for example, our largest market there, Brazil. In Brazil, we had Black Panther results 30% above Guardians of the Galaxy, 23% above Wonder Woman, 6% above Deadpool. So it was a very, very important movie for us, obviously, from an industry standpoint and also for Cinemark. Regarding Star Wars, Star Wars is a movie that did extremely well in the United States. Traditionally, the Star Wars franchise has done well in Latin America, but not to the same extended super blockbuster level that it does in the United States or other parts of the world.



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Michael Ng - Goldman Sachs Group Inc., Research Division - Research Analyst

Great. I just have a housekeeping question. Sean, could you help us unpack the cash distribution from equity [investment] number? Of the \$9 million, how much was from NCMI and how much was from other equity investments, whether that was DCIP or anything else?

Sean Gamble - Cinemark Holdings, Inc. - CFO & COO

Sure. In this particular quarter, the bulk -- just about all of it was from NCM for fourth quarter 2017.

Michael Ng - Goldman Sachs Group Inc., Research Division - Research Analyst

And was that -- was the tax receivable in there? Or was it just -- was it -- that's just recurring?

Sean Gamble - Cinemark Holdings, Inc. - CFO & COO

It was just the recurring dividend.

Operator

Your next question comes from Eric Handler with MKM Partners.

Eric Owen Handler - MKM Partners LLC, Research Division - MD, Sector Head & Senior Analyst

Just a couple of quick things. The Movie Club membership, just curious what you're seeing. Is there any unusual patterns of geographic dispersion of people who are signing up? Or is it pretty steady throughout your circuit?

Mark Zoradi - Cinemark Holdings, Inc. - CEO and Director

Eric, thanks for asking that question. Actually, it has been very spread out throughout the entire circuit. We anticipated maybe a little bit more strength in California, it's clearly been strong in California, but it's been equally strong in Texas as well. And so we're seeing it across the entire country. And obviously, we're promoting it in each one of our theaters, so we would expect that. But it's been very rewarding to see how it's spread out relatively equally around the 41 states that we operate in.

Eric Owen Handler - MKM Partners LLC, Research Division - MD, Sector Head & Senior Analyst

That's great. And as a follow-up. Just as -- you had very strong margins in the U.S. market, but it did look like your payroll expenses did go up a bit. Anything unusual in the payroll items there at all?

Sean Gamble - Cinemark Holdings, Inc. - CFO & COO

Wouldn't say that there's anything necessarily unusual in the details. And as I kind of mentioned, there is a component of that payroll which is just general inflation as well as certain minimum wage hikes across the circuit. The rest is really driven by the initiatives that we're pursuing, which can have a little bit of an uptick in payroll. But as you've seen from the overall results, they're driving excellent growth in -- particularly in our concession sales and just as well as overall EBITDA across the circuit.

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Eric Owen Handler - MKM Partners LLC, Research Division - MD, Sector Head & Senior Analyst

Great. And just one last question with regards to capital returns. You're growing your dividend quite nicely at a 10% rate, which is greater than your EPS growth in the year. But with tax reform, CapEx going about \$30 million lower, at least initially, expectations for that. Curious how you're thinking of what happens, particularly as you go below 2x net leverage, how do you think about that excess cash growing on your balance sheet? Do you think about an above-average increase next year, maybe, for the dividend? Do you think maybe at this point you think about a modest share buyback program? And is there much to do with M&A at this point?

Sean Gamble - Cinemark Holdings, Inc. - CFO & COO

I would say these are all things that we are constantly evaluating as part of our ongoing capital allocation strategy. We've said in the past that we don't have necessarily a set leverage target. We have hovered around that 2x level, and I wouldn't anticipate seeing us get too much below that. So right now, we've done this more immediate dividend increase of 10%. As mentioned, we obviously are looking to another year of somewhat elevated CapEx in 2018, so that just kind of has played into our thinking in terms of the most current actions. We figured those were the most -- that was the most prudent way to kind of disseminate some of the recent benefits of tax reform. We're obviously going to continue to evaluate future plans just as part of our -- again, our ongoing capital allocation evolution, which could materialize in other things, but those have not been decided yet.

Operator

Your next question comes from Julia Yue with JPMorgan.

Yang Yue - JP Morgan Chase & Co, Research Division - Analyst

You guys mentioned that your recliners are still generating returns well above the 20% ROI target, and you're looking to convert at a pretty healthy rate in 2018 following meaningful acceleration in 2017. I was wondering, what sort of markets are these new conversions planned for? Are they primarily markets that already have competitors with recliners or ones where there'd be a new offering? And are you seeing the returns come down at all for these newer conversions?

Mark Zoradi - Cinemark Holdings, Inc. - CEO and Director

Julia, there's no specific relative to large or small markets. What we do is we look for any opportunity where we think that particular market would benefit from it. We run a very detailed financial analysis and projections to at least give us as much security as possible that we're going to have above our threshold returns. Yes, from the very highest level of when you first start and you're picking your absolute best, the returns in the very beginning, it's the -- they're not as strong as the very first ones, but they're still way above our 20% threshold margin, so we're going to continue to do it. You may have noticed that we have slowed down the rate of increase of our recliners. I would (inaudible) the brakes on, rather, I would categorize it as we'd let slightly off the accelerator. And that's just because, obviously, the first ones, there's more opportunities. And as you get deeper and deeper into the circuit, we anticipated, as I mentioned in the prepared remarks, that we're going to be somewhere just north of 40%. We really pushed during the fourth quarter for 2 reasons: One, we saw the opportunities that were there; and two, we wanted to get them done prior to Star Wars and other major pictures that we saw coming out. So we pushed to get as much as 45% of our circuit reclined in 2017. As we said, we're looking at probably increasing that to 55% in the coming year. So I would call it a continuation, a slight reduction in the acceleration, with a continued anticipation that the returns that we're going to get are going to be north of that 20%, in truly a variety of markets. It's hard to categorize any specific category because we look at it theater by theater, film zone by film zone. Sometimes, we're the first into the market, sometimes we're not. So it really is dependent on each individual situation.



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Yang Yue - *JP Morgan Chase & Co, Research Division - Analyst*

Got it. And then could you also give us an update on Latin America box office trends for the first quarter outside of Black Panther, which obviously did so well? I know there are few films pushed out to Q1 from Q4. Any thoughts there would be helpful.

Sean Gamble - *Cinemark Holdings, Inc. - CFO & COO*

Sure. We're optimistic about the first quarter internationally, particularly, as you just indicated, some of the larger films that helped benefit the U.S. in the fourth quarter, like *Coco* in Brazil and Argentina; *Ferdinand* in Brazil, Argentina and Colombia; and *Jumanji* in Brazil and Argentina, all of those got pushed into the first quarter to capitalize largely on the school holidays that take place there during the summer. So we think all those, as well as *Black Panther*, which has done particularly well in Latin America, much like it has done in the U.S., all bode well for first quarter results in LatAm.

Operator

Your next question comes from Leo Kulp with RBC Capital Markets.

Leo J. Kulp - *RBC Capital Markets, LLC, Research Division - Associate*

My question is really around the M&A outlook. I mean, there's been some M&A in both the exhibitor and studio spaces the last call. So when you look out 5 years, do you see the global cinema space as being meaningfully more consolidated? And since you guys have had a presence internationally for a while now, what do you see is the key benefit of global consolidation?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Leo, I do think that there will be continued M&A and some level of consolidation as we move forward. Clearly, we have an interest in it. I would say, maybe we're the most disciplined and careful in that approach. Because whenever we do M&A, we are -- we're just emphatic that it's going to be accretive to the shareholders, so we're a little bit more careful. But we are looking at every single deal. We're focusing our attention in terms of mining deals and building relationships for future deals in markets that we already operate in. So I would say the Americas, less Mexico. So I think you'll see us finding some opportunities in the coming 12 to 24 months. Usually, it's around some form of estate planning generation moving in terms of an opportunity where a particular family, for whatever their reasons are, choose to sell that particular asset. And there are some opportunities for that in the United States. And definitely, there's some opportunities for that in Central and South America. So for us, we look at other deals. We look at deals on a worldwide basis. But where do we really go look to mine deals and build the relationships? It's where we currently are. Because we have such an expertise in the countries that we currently operate in, and we think that going deeper and having a greater penetration in those countries has more strategic value for us than to spread ourselves into new territories with a relatively small market share.

Leo J. Kulp - *RBC Capital Markets, LLC, Research Division - Associate*

Got it. And do you see major benefits from being a global company? Is there -- do you see cross-border...

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

I -- for us, there clearly is, because it gives us the opportunity to have a level of diversification. Our -- the growth prospects for us in Latin America are significantly greater than they are in the United States. We traditionally have grown in the U.S. 1% to 2% from an organic or -- an organic way; and in Latin America, we look to grow 5% for 6%. So we see Latin America with continued growth opportunities throughout the whole region, even in the midst of some of the economic issues we've had. Where Brazil has slowed down, you know what, Colombia and Peru and Central

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America have picked up. So we continue to believe that we're going open 50 to 75 new screens in the coming year, like we did last year. And in the U.S., we're pretty optimistic about our opportunities going forward this year, too. We have 6 or 7 theaters in the pipeline for 2018.

Leo J. Kulp - *RBC Capital Markets, LLC, Research Division - Associate*

And if I could, Sean, one quick question for you on the utility expense domestically. It was really strong. And I apologize if I missed it, but what was the driver of that big decline in utility expense?

Sean Gamble - *Cinemark Holdings, Inc. - CFO & COO*

Sure. We had a -- there are basically 2 components. One was just a slight classification change of transaction fees that created a benefit in utilities and other, as well as decreased equipment lease expenses for our 3D presentations. Those were the 2 things that really impacted it. Without those, it would have been just slightly up.

Operator

Your next question comes from Eric Wold with B. Riley FBR.

Eric Christian Wold - *B. Riley FBR, Inc., Research Division - Senior Equity Analyst*

Just a couple of questions. One, kind of digging back into the impressive concessions growth in a different way. Of the 8.7% growth, I guess, maybe not focus on Q4, maybe to kind of look at 2017 as a whole, can you give us a sense of how much of the increase in spend was driven by increased spend per patron on average or -- and versus a greater number of patrons actually making a purchase versus not before? And where do you think you can take both of those levels over time?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

I'm going to take just a little bit of that, Sean may jump in with some additional detail that I don't have in front of me. Really, what's happening on concession is we are creating and providing to the consumer a significantly larger element in terms of choice. So we're getting consumers to the concession stand that haven't been there before. We're offering additional items. Probably, the most significant one that we're doing for 2018 is the Pizza Hut initiative, where we're going to roll that out in a significant number of theaters, and it's a whole new category of a branded pizza category. And what we found is when we add additional menu items, and we do that on both the -- on a regional basis and a national basis, depending on taste, what we find is it's usually incremental, and it's -- there's very little cannibalization of back -- of our existing items. And so what we're doing is we're getting people that haven't been purchasing before coming to the concession stand because they've got items that they're now interested in. And it also is allowing people to actually just buy more. And then one last thing is, as we further recline, every time we recline a theater, we tend to get a higher per cap in that theater. And part of that is related to reserved seating. When we reserve -- when we recline an auditorium, we always reserve the seats. When you reserve the seats, people walk into the theater. They have a little bit more time on their hands, they don't have to rush in to get a seat and they tend to go to the concession stand more and that increases both incidence and per cap. Sean, you may have a little bit more detail there.

Sean Gamble - *Cinemark Holdings, Inc. - CFO & COO*

Sure. The point I would add is the 55% of the growth that's coming from our initiatives, I would say -- and hopefully, this gets at your question, Eric. I would say about 1/2 of that is really directed from our core concessions, that would be soft drinks, popcorn, candy, looking for new ways to kind of stimulate incidence of purchase through promotions and things of that sort. The rest there would be coming from kind of new, expanded



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offerings, whether that be alcohol, merchandise or other types of things like the Pizza Hut initiative that Mark described. So I hope that gets kind of at what you were asking.

Eric Christian Wold - *B. Riley FBR, Inc., Research Division - Senior Equity Analyst*

No, it does help. And I guess it can -- well, the answer's going to help on my follow-up question. I guess, what percentage of your tickets right now are being sold in advance for reserved seats? I guess, where do you expect that to go? And then do you have an idea, given that people are purchasing tickets in advance, and they're coming to the counter or to the ticket taker with their digital tickets or kind of the credit card, how far in advance of the show start are these consumers arriving at the theater?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Usually, we put our movie times up somewhere around a week in advance. If it's a big blockbuster, those will go in advance much sooner, it could be weeks in advance. So we'll start to see movies like the Black Panther or Star Wars or one of the other Marvel pictures weeks in advance because we put them up. But we're seeing as much as 50% of our tickets sold now in our reclined reserved seats going in advance. And then when people come, it's a variety of things. Some of them have it on the phone and they go straight to the podium. Some of them go and get a printed ticket and then walk to the podium. So it's a variety of how -- it's just like in the airport. Some people put it on the phone and some people actually get a printed ticket. So we're experiencing the same thing. But we're moving people more and more to mobile devices because, obviously, the convenience factor for the consumer, and then also it saves on labor for us.

Eric Christian Wold - *B. Riley FBR, Inc., Research Division - Senior Equity Analyst*

And what is average amount of time ahead of a show start are these people arriving for reserved seats?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

There's a variety of -- I couldn't give you a specific amount there, but people tend to arrive somewhere in the 15 to 30 minutes ahead of time, and it depends on whether or not they want to buy concessions or whether or not they want to hang out and have a glass of wine or a beer, because we're now -- we now have nearly 1/3 of our circuit offering some form of alcohol and on our way to 50%, 55% of our circuit offering expanded food. So there's more reason for people to come early because there's more options for them.

Sean Gamble - *Cinemark Holdings, Inc. - CFO & COO*

I would just add, we initially were worried that reserved seating would actually have a negative effect on concessions, just because people won't feel the need to get there to get their seats. We've seen the exact opposite effect, where because they had their seat, they take more time, kind of as Mark said, shop and enjoy more consumption than they had historically. So we've seen a net benefit there.

Operator

Your next question comes from Robert Fishman with MoffettNathanson.

Robert S. Fishman - *MoffettNathanson LLC - Analyst*

I have one for Mark and one for Sean. Mark, just given the additional ramp in recliner upgrades this year, just wondering, where do you think this ends up longer term as a percent of your U.S. circuit?



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Mark Zoradi - Cinemark Holdings, Inc. - CEO and Director

Robert, we've been successful in not giving out any predictions like that because I think you can only be one -- only one thing can happen there, you can be wrong. We take it in such a disciplined way, where we look at it literally month by month. And like we told you last year, we're going to be at 40%, we ended up at 45%. We're telling you this year we're going to be at 55%, we're going to be in that category because we take it and we look at the opportunities. We're very fortunate to have the capital and the flexibility to act quickly when we see the opportunities. So it's -- I'll put it this way. I'll go out on a limb for you here. It's never going to get close to 100% because there are too many theaters and too many locations where we and our competitors are going to want this seat capacity. And there are certain markets where it just doesn't justify the expense of going in and redoing the whole theater. But we're going to be, like we said, probably at about more than 50% of our circuit, 55% of our circuit by the end of the year. We'll probably slow down a little further as we get into 2019. But at this point, we're not ready to give any guidance there.

Robert S. Fishman - MoffettNathanson LLC - Analyst

Okay. Fair enough. And for Sean, I guess, on a somewhat related note, given the success of the reseating initiative, can you just help us think about the difference in contribution from the core nonupgraded U.S. circuit compared to the resealed seats for maybe full year '17 on revenue and EBITDA? And how should we think about that growth in '18, including any initiative to drive up ticket price for the upgraded screens?

Sean Gamble - Cinemark Holdings, Inc. - CFO & COO

Sure. Let me go after kind of your first part of your question in just -- answer it maybe a slightly different way. When we look at kind of the growth we've seen in our box office across our domestic circuit, we look at our non-reclined theaters versus our reclined theaters, the non-reclined theaters we've seen have generally been performing fairly close to the industry, to the extent they haven't been adversely impacted by some type of competition in their marketplace, whereas our recliners are certainly been over-indexing the overall industry results. So we're definitely seeing a clear, clear benefit from the recliners with regard to that. Our overall ticket price benefit, I think we've said that recliners will tend to be able to take incremental ticket uplifts. I forget -- what are we? 1.5% to 2% times more growth than we've seen in our non-reclined theaters. When we look at our ticket pricing for the fourth quarter, I would say, it drove -- recliner pricing probably drove about 1.5% of the price increase we saw in the fourth quarter.

Operator

Your next question comes from Jim Goss with Barrington Research.

James Charles Goss - Barrington Research Associates, Inc., Research Division - MD

All right. There was a recent Wall Street Journal article about new shopping center development in Mexico. And I know you got out of Mexico, your original market, I believe, because of the competitive environment. But I was wondering if there's any chance you would find it attractive to move back into Mexico or perhaps even take a run at 1 of the 2 major operators that remain.

Mark Zoradi - Cinemark Holdings, Inc. - CEO and Director

Jim, we don't have any plans to move into Mexico at this time. We're very pleased with our business in Central and South America. And we don't have any plans either to make any run at an acquisition of the 2 major players in Mexico.



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James Charles Goss - *Barrington Research Associates, Inc., Research Division - MD*

Okay. And you also mentioned how the Hollywood slate appealed to the Latin American markets. I was wondering if at this stage of the year you could rate this year's slate in terms of your expectations as to the relative appeal to your markets there?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

I would say it's good. What's always going to completely over-index in Latin America is going to be the strength of family product. So as the family product rolls out and the success of it and how commercial it is, that will be a determinant of how well it does. Second thing is local content. Local content is harder to have a window into. You don't get as much advanced notice on local content. However, we do know that there's a very important Brazilian movie coming later in the year that we think will be very successful. But the effect of having the Disney product and some of the Universal product relative -- is very, very important. So I would put it somewhere about equal and try not to handicap it either way.

James Charles Goss - *Barrington Research Associates, Inc., Research Division - MD*

Okay. And lastly, there was a lot of drama last year in the domestic market in particular, and I've tended to think the 5 consecutive down quarters heightened sensitivity to other issues, big and small. And I'm wondering what your thoughts are in terms of any issues, positive or negative, that will be top of mind this year as it plays out.

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Well, just in -- as I think back to last year, 5 quarters, the first quarter was a record first quarter in the history of the industry. So that clearly wasn't a down quarter. The second quarter was down -- off the top of my head, down 3.5%, 4%. And as I'd like to say, if Beauty and the Beast had moved 2 weeks, the second quarter would have been probably up and the first quarter would've been down. So I try not to put -- we try not to put too much emphasis on quarter by quarter because, literally, one movie can swing that. And then of course, the third quarter was down in '17, and the fourth quarter was back up again. So -- and then as everybody was looking at the first quarter of '18, I think the consensus was that the first quarter was going to be significantly down until there's a little movie called Black Panther decided to set all records of records, and now the first quarter is at a much stronger position. We think the second and third quarter are strong as well. The fourth quarter won't have a Star Wars, but it's a -- it looks good, too. So again, the message that I think is appropriate -- and we've been doing this for a long time, either on the studio side or the exhibitor side, is try not to focus quarter by quarter because one movie can make such a dramatic difference, whether it's a Suicide Squad, whether it's a Black Panther, whether it's a Beauty and the Beast. So we think 2018 is, again, going to be a good, strong year. And equally so, we think what we've seen for 2019 already looks to be a very strong year.

James Charles Goss - *Barrington Research Associates, Inc., Research Division - MD*

No. And I appreciate that. I'm just thinking, during the handwringing times in midsummer, it seems that's when PVOD and some of the other sort of side issues seem to be bubbling to the surface and dominating the discussion. And I just wondered if there was anything along that nature that you think are of concern to you this year?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

I don't think so. In all of our discussions with our studio partners, there is not a big emphasis or talk going on relative to PVOD. I think you've seen that in some of the recent best publications, Wall Street Journal, probably the top of them, but that's also consistent with our individual discussions with the studios. I think with the Time Warner acquisition going on, with the Disney-Fox acquisition going on, with the improvement in the box office, with all the alternatives that consumers have at home already, I think there's less enthusiasm amongst studios right now to push a PVOD agenda.



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Operator

(Operator Instructions) Your next question comes from Ben Swinburne with Morgan Stanley.

Benjamin Daniel Swinburne - *Morgan Stanley, Research Division - MD*

A couple of questions. Mark, where does Cinemark fall on the Disney-Fox merger at this point? Is that a combination at the studio level that you think is something the government should be thinking about blocking given the impact on maybe rental splits given the consolidation there? Or do you see some positives in the Disney? Clearly, it's been the best executing studio for a long time, and now it will have -- potentially have Fox's IP in house, and Disney has been much less vocal, particularly to your previous point about PVOD, so this is probably a positive in that direction. How are you guys thinking about this proposed merger and the impact on your business?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

I would say the latter of what you said. We think there's a lot of -- we think it's a very positive item for both Disney and Fox. There's -- Fox is a great developer and creator of content. They're going to combine together with probably the best worldwide marketing machine in the motion picture industry. So we think the combination of that is going to be good for promoting movies and making movies. And so we're positive. And we also really appreciate Disney's stance relative to Windows, and so we fall much more in the positive side of that.

Benjamin Daniel Swinburne - *Morgan Stanley, Research Division - MD*

Great. And then on Movie Club, what's your expectation for how big that business gets you? I know it's very early, but I'd love to know, based on what you've learned so far, how many of your patrons do you think are maybe likely to move into that product? And how do you guys look at the unit economics when you compare someone moving into a Movie Club subscription versus just behaving as a typical normal patron? Is that always economically attractive for you? Are there trade-offs? And any comment on marketing support as you push forward into '18 on that business?

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Well, number one, we love the concept of a reoccurring revenue stream. And we are absolutely convinced. It's a little early, we're 80 days in, so it's a little early to say to give -- for us to give your metrics on increasing of attendance. But we just know that from our research that consumers who have built up credits already on their phone and they can come, and effectively they feel like they've already paid for it, and they can bring a guest with them and they can get all the benefits that we have, we really truly believe that, as we look back 6 and 9 months from now, that it's going to increase attendance. So this is about a loyalty play, an increasing attendance play. Relative to how much it grows, boy, that's hard to say. We've been growing at 9,000, 10,000 new members each month in the 12 weeks that we've been out there. It's -- there has been tremendous success. We've got ambassadors in all of our theaters promoting it and talking to consumers about it. And so we're very positive about the potential for it, but I think it's a little early to throw out any projections.

Benjamin Daniel Swinburne - *Morgan Stanley, Research Division - MD*

Sure. And then just 2 for Sean. I don't if you mentioned anything on cash taxes going forward. I'm just curious how much of your CapEx is eligible for immediate deductibility? And then on your new term loan, is any of that debt been swapped or planned to be swapped into fixed? Just asking given we're seemingly moving into a little bit of a new rate regime for the first time in a long time.



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Sean Gamble - *Cinemark Holdings, Inc. - CFO & COO*

Sure. Just quickly in the last point, it is something we're looking at. We haven't made a decision as of yet, but we're kind of evaluating that closely. From a cash tax perspective, we certainly expect to derive a significant benefit from tax reform. One of the things that, I guess, we're still evaluating with regard to the qualification of reinliners is just the -- some changes in qualified improvement property. So there's some questions, it appears, at this moment that capital such as that, while once would have qualified for bonus depreciation may no longer. Something that's still, I guess, in review in D.C. So at the moment, we're not expecting that, to be able to have a benefit there. Just worth noting that new builds never qualified for that bonus depreciation. So I would say the way I would guide the kind of look at it is, we expect, as I mentioned, our effective tax rate to go somewhere into the mid- to high 20% range. The amount of actual cash taxes that we'll have will depend somewhat on our net income before taxes. So I think you'll see the benefit of that new effective tax rate applied to that net income before taxes play through. And then I would say, I think it's pretty safe to assume a slight incremental benefit for bonus depreciation if you're trying to assess what the cash tax implication would be.

Benjamin Daniel Swinburne - *Morgan Stanley, Research Division - MD*

Okay. So it sounds like cash taxes might be a touch below book, if I'm hearing you right.

Sean Gamble - *Cinemark Holdings, Inc. - CFO & COO*

To -- there's some nuances that go into that, but I think that's probably a safe assumption to make at this point.

Operator

Your final question comes from Chad Beynon with Macquarie.

Chad C. Beynon - *Macquarie Research - Head of US Consumer, SVP, and Senior Analyst*

Sean, just one for you, kind of a follow-up to that last question. And congrats on the promotion in the quarter. Well deserved. Just with respect to the repatriation of your cash. How do you plan to kind of parse out where the cash sits in the U.S. and then internationally? And does this kind of force your hand a little bit to, I guess, medium term, given -- having cash there for potential M&A opportunities? Just a question on that.

Sean Gamble - *Cinemark Holdings, Inc. - CFO & COO*

Sure. There was a -- we didn't actually have to distribute real cash to the U.S. from international. The cash that we have internationally is still sitting internationally and largely being recirculated for working capital and growth needs. There was a deemed repatriation tax that was applied to offshore undistributed earnings. So that -- the amount of that played through into the provisional tax items that we booked in the fourth quarter already. But I would say the effect of the tax reform isn't necessarily impacting the logistics of where our cash is today versus where it was before.

Operator

That concludes the Q&A session for today. Now back to you for closing remarks.

Mark Zoradi - *Cinemark Holdings, Inc. - CEO and Director*

Thank you all very much for joining us this morning, we look forward to speaking with you again following the first quarter. Have a good day. Bye now.

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