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THE BUYOUT OF AMC ENTERTAINMENT

In July 2004, Sean Penmeyer, a principal at J.P. Morgan Partners (JPMP, the private equity arm of JPMorgan Chase & Co.), was in the midst of formulating the final terms of a public-to-private buyout proposal for AMC Entertainment Inc. (AMCE). Always alert for new investment opportunities, JPMP had invested in the theater industry before and had started a process earlier that year to learn more about the current state of the market. The interest was prompted by a gradual recovery in theater attendance since the recession and post–September 11 downturn. Big hits in 2002 and 2003 such as *Spiderman, Finding Nemo, Lord of the Rings,* and *Matrix Reloaded* had brought crowds back to the theaters and increased merger and buyout activity in the sector. Through various industry sources, Penmeyer had learned that AMCE might be looking for potential investors. On April 30, 2004, a senior partner at JPMP telephoned Peter Brown, chairman, president, and chief executive officer of AMCE, to gauge his interest in further discussions with JPMP.

Earlier in the year, AMCE's board had explored several opportunities to create value for shareholders. Those included acquisitions, strategic combinations with other theater companies, and a possible recapitalization of the company to simplify its capital structure. Several past investments, including a $250 million equity infusion by Apollo Management, L.P., in 2001, had left AMCE with two classes of convertible stock in addition to its publicly traded common shares. It was the board's belief that a simplified share structure—one with a single class of common stock—would remove the overhang of the preferred shares and more fully align the interests of all of AMCE's shareholders. Most important, during that conversation, Brown indicated that the board was not averse to an outright buyout of the company.

Sensing opportunity, JPMP set its forces in motion to consider a possible buyout of AMCE. There were several issues to consider. First, based on their previous analysis of the industry, JPMP's initial impressions were that AMCE was an attractive buyout candidate. The company was viewed as having a premier circuit of theaters, which were on average larger, more efficient, and more professionally operated than those of its competitors. Brown and his management team were also widely regarded as one of the best in the industry, with a reputation for well-oiled operations and continuous innovation, often in areas where others saw no

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This case was prepared by Vikram Patra (MBA '06), Stephan Oppenheimer (MBA '96), and Susan Chaplinsky, Professor of Business Administration. It was written as a basis for class discussion rather than to illustrate effective or ineffective handling of an administrative situation.

opportunity. Further, the market did not appear to have fully recognized the company's true value, as AMCE traded at lower multiples compared with its industry rivals. Nonetheless, further due diligence would be required to confirm just how sensible a buyout candidate it was, particularly in an industry with a history of recent financial problems. Second was the issue of how high a premium JPMP could offer above AMCE's current price of $16 per share and still make its targeted return. Third was the issue of feasibility and whether a deal could be completed. Any deal JPMP could envision would involve not only the repurchase of AMCE's common shares but also the Series A convertible preferred shares and Class B convertible shares. As holder of 94% of the Series A shares, Apollo could block any acquisition; therefore, gaining its approval was as important as gaining the board's approval. If Apollo sold out entirely, JPMP would have to contend with the loss of an influential investor and raise considerably more capital. As Penmeyer framed the issue, "At too high a price, Apollo is an outright seller; at too low a price, no deal can be done. We needed to find some middle ground to be able to get the deal done with Apollo's approval and maybe participation and make sure the economics worked for us."

The Market for LBOs

LBOs grew to prominence in the 1980s following a merger wave of the 1970s that focused on the benefits of conglomeration.[1] Corporate diversification was seen then as a means to gain size and reduce fluctuations in earnings. Over time, it became clear that diversified corporations often suffered from high overhead, slow reaction time, misaligned incentives, and politicized decision-making. Proponents of LBOs saw them as a means to transform an inefficient corporate sector. Michael Jensen, in an article in *American Economic Review*, argued that LBO transactions allowed firms to operate with more focused strategic goals and achieve better results for shareholders.[2] He articulated the famous "carrot and stick" mechanism at the heart of an LBO. First, "the carrot" was the strong managerial incentives an LBO provided through equity participation. Prior to LBOs, management-owned stock and stock-related compensation were rare and implementing the right equity ownership plan provided management with an incentive to work harder and better aligned the interests of management and shareholders. Second, "the stick" was the managerial discipline created by high debt service requirements. Jensen characterized the ideal LBO target as "firms or divisions of larger firms that have stable business histories and substantial free cash flow (i.e., low growth prospects and high potential for generating cash flows)—situations where the agency costs of free cash flow are likely to be high." Managers in such firms had incentives to spend free cash flow to grow the business often on investments with low returns to shareholders. The high level of post-buyout debt forced management to distribute the firm's free cash flow to debt service rather than to value-dissipating investments.

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[1] This section draws heavily on Li Jin and Fiona Wang, "Evolution of the LBO Industry and Future Trends," *Perspectives* 3, no. 6 (2002): 3–22.

[2] Michael Jensen, "Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers," *American Economic Review* 76, no. 2 (May 1986): 323–29.

In the early 1980s, most LBO target companies were "mature, stable, asset-rich companies with low capital needs." The LBO financing structure was relatively conservative and appropriate for the underlying business risk. Hence, the benefit of debt outweighed its disadvantages, leading to the success of a majority of those LBO transactions. The high returns to early buyout sponsors did not go unnoticed and spurred entry into that lucrative market. The growth of LBOs was aided by the development of the high-yield bond market, which provided public market financing for the deals. Issues of high-yield bonds grew from $1.3 billion in 1980 to $30.3 billion in 1986.

Although the early LBO market created significant shareholder and sponsor gains, the market began to fray in the late 1980s. The decline has been attributed to the high valuations paid for LBO targets—facilitated by the ready financing provided by high-yield debt, excessively high amounts of leverage, a movement toward riskier LBO targets, and other characteristics associated with an "overheated" market.[3] Following the failure of a prominent LBO deal in 1989, the default rate on high-yield debt rose from 3.5% in 1986 to 10.3% in 1990. LBO failures accelerated in the recessionary period of the early 1990s so that by 1992, there were approximately 42 corporate bankruptcies with liabilities over $100 million versus fewer than half that many in 1989.[4] At the market's lowest point in 1991, the once high-flying LBO operators found themselves shunned by Wall Street and their very survival was questioned.

Recent LBOs

From the market's low point, leveraged buyouts only gradually recovered through 1995. Thereafter, the buyout market started to recover in earnest until the post–September 11, 2001 downturn. **Exhibit 1** shows that the volume of LBOs peaked at $56.7 billion in 1998 and declined precipitously in 2001 and 2002 before mounting a strong recovery to $46.8 billion in 2003. Even at its high point in 1998, however, the volume of LBOs still fell well short of the volume in the late 1980s. Recent LBO deals were also markedly different from those done in the 1980s. Recent LBOs featured fewer ideal targets, more intense competition, less-leveraged capital structures, different sources of value creation, and sharply reduced industry returns.

Fewer ideal targets

The current LBO environment featured far fewer good targets than in the 1980s. During the early 1980s, the aforementioned supply of inefficient conglomerates provided ample room for buyout firms to benefit by improving management incentives and disciplining free cash flow. Company valuations and productivity were also extremely low. By the mid 1990s incentive-based compensation, once scarce, became more commonplace and enhancing shareholder value became the mantra of corporate board rooms. The implementation of programs to increase

[3] Steven Kaplan and Jeremy Stein, "The Evolution of Buyout Pricing and Financial Structure (Or, What Went Wrong) In the 1980s," *The Quarterly Journal of Economics* 108, no. 2. (May 1993): 313–57.

[4] Edward Altman and Pablo Arman, "Defaults and Returns on High Yield Bonds: Analysis through 2001, *Journal of Applied Corporate Finance* (Spring/Summer 2002): 7–21.

shareholder value along with increases in productivity spurred by technological advances resulted in higher values for investee companies. In addition, the U.S. economy had been shifting from manufacturing industries toward service industries, and the latter were harder to leverage due to their greater intangible asset base. As a consequence of all the above factors, the "low-hanging fruit" had disappeared and ideal buyout targets became harder to find.

More intense competition

Pioneers of LBOs such as Henry R. Kravis and Theodore J. Forstmann—founders of two of the earliest LBO firms—who once had free rein now faced numerous competitors. In addition, the industry had raised larger amounts of money. The expansion could (at least partially) be attributed to the significant growth of large state pension systems and their increased investment allocations to alternative assets. According to Asset Alternatives' 2001 research report, aggregate buyout fundraising expanded from 1991 to 2000 at an annual rate of 34%.[5] As a result, buyout funds had larger amounts of capital under management and the transactions grew larger. **Exhibit 2** shows that the average size LBO grew from $360.5 million in 1997 to $756.5 million in the fourth quarter of 2003—a twofold increase. Relative to the 1980s, there were simply more well-financed funds concentrating on the late-stage and buyout areas.[6] Buyout firms also found themselves competing against a wider range of players, including strategic buyers. As the latter generally could bid higher prices owing to business synergies than financial buyers, purchase price multiples for large LBOs had been trending up (**Exhibit 3**).

Less-leveraged capital structure

Since the 1980s, the high-yield market grew larger and more diversified in the types of firms and activities it financed. In addition, the mezzanine market experienced steady growth throughout the last decade with its increasingly important role in buyouts that were too small to be financed in the high-yield market. Offsetting those positives was a contraction in the senior debt market which lagged the growth in buyout activity. The average multiple of senior debt to EBITDA contracted from 3.6 times EBITDA in 1997 to 2.9 times EBITDA in 2003. Further, industrywide consolidation among financial institutions in the late 1990s also increased the bargaining power of senior lenders at the expense of buyout firms. In general, creditors were no longer willing to accept the extremely high leverage ratios prevalent in the 1980s. A survey of general partners by Asset Alternatives in 2001 revealed these changes in LBO capital structures. For LBOs done in 1986–90, senior debt made up 56% of the financing, high-yield debt 19%, mezzanine debt 5%, and equity 18% of total capital. For deals done in 1996–2000, senior debt dropped to 33% of the financing, high-yield debt increased to 27%, mezzanine debt increased to 9% and equity increased to 32% of total capital.[7] **Exhibit 4** shows that the trend toward larger equity stakes continued so that by 2003 the average buyout had 39% equity financing.

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[5] "Strategies for Successful Buyout Investing," *Asset Alternatives*, 2001.

[6] Even since 1997, there had been pronounced growth in the buyout area. *Venture Economics* estimated that the number of firms/funds had grown from 404/637 in 1997 to 557/998 in 2003. The total capital in the industry grew from $187 billion to $450 billion over the same period.

[7] *Asset Alternatives*, 2001.

Different sources of value created

The reduced reliance on debt in recent buyouts meant that larger operating improvements were needed to create value. **Exhibit 5** illustrates how the components of buyout returns had changed over time. From 1986 to 1990, financial leverage contributed 41% to average buyout returns, followed by operating improvements (34%), multiple expansion (14%), and multiple arbitrage (11%).[8] By contrast, from 1996 to 2000, operating improvements increased to 43% of average buyout returns, followed by financial leverage (24%), multiple expansion (22%), and multiple arbitrage (11%). Recent buyouts relied more on operating performance and growth strategies to achieve their returns. Commenting on those changes, Henry Kravis noted:

> Thirty years ago, the hardest work occurred before we made the investment. Today we work hard before we make the investment, but we work harder after we make the investment.…None of us make money at the time of the acquisition. We only make money because we improve the operations of the newly acquired company, and, subsequently, if capital markets are strong, utilize this capital to our advantage. As a result, we've had to get more skilled at building businesses.[9]

Sharply reduced industry returns

As the industry had grown more mature and specialized, the mean industry return dropped sharply, making the abnormally high returns of early LBOs more difficult to achieve. **Exhibit 6** shows investment multiples for U.S. buyout funds from 1980–2003. Since the early 1990s, investment multiples had declined from roughly 2.0 to less than 1.0 times total paid in capital in 2003. Similarly, the annual returns on buyout funds had dropped from the lower 20% range in the mid-1990s to negative from 2000 to 2002 before turning positive again in 2003.

Although the foregoing factors pointed to a more difficult buyout market than the heyday of the 1980s, several factors favored current buyouts**.** For one, interest rates were at all-time historic lows. For another, equity valuations, which were well above historical levels in the late 1990s, burst with the tech bubble of 2001, resulting in more perceived bargains and greater opportunity for buyout firms to profit upon exit. Lastly, the passage of Sarbanes-Oxley in 2002 had increased the disclosure and reporting requirements of public firms, causing firms—particularly small firms—to question the benefits of being public.

Apart from those broader market concerns, Penmeyer saw AMCE as right up JPMP's alley. JPMP had been in the buyout business since 1984, it currently had more than $15 billion in assets under management, and the partnership had experience with large transactions such as AMCE. Jeffrey Walker, the managing general partner, had been with the firm since its inception. The firm typically invested $100 million to $300 million or more of equity per investment across

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[8] "Multiple expansion" refers to industrywide growth or cyclical expansion. "Multiple arbitrage" refers to deal-specific differences between the purchase price and sale (exit) multiples.

[9] Henry R. Kravis, keynote speech: "Proactive, Patient, Creative," delivered at the *Private Equity Analyst* conference in New York City, 22 September 2004.

many industry sectors, including media and entertainment. Past investments had included companies such as Cabela's, Guitar Center, Kraton Polymers, and National Waterworks. JPMP generally preferred to look for targets with experienced management teams that they could partner with to create value by driving revenue growth and unlocking cost efficiencies.

In considering the AMCE buyout, JPMP had to carefully assess Apollo Management, L.P., as a potential partner. Penmeyer knew Apollo by reputation as an active investor with an instinct to invest where others would not go. Headed by Leon Black, Apollo had earned its reputation as a vulture investor by specializing in distressed assets (junk bonds, troubled companies, real estate). Black had walked away from the wreckage of Drexel Burnham Lambert in 1990 with a reputation as a shrewd investor, and six months later opened a private investment firm specializing in Wall Street's most contentious specialty: vulture investing. Over time the firm had achieved considerable success and currently had approximately $13 billion in equity capital invested in a wide variety of industries. In the case of AMCE, Apollo's contrarian instincts had again surfaced. Its investment of $250 million in 2001 had come at a time of crisis in the theater industry, when a number of AMCE's competitors had filed for bankruptcy. Now, Apollo was looking to cash out some of its earlier investment—how much to cash out was the key issue. "We knew Apollo was a smart operator," Penmeyer said, "and if we could convince them to invest in the buyout we knew they would want what we wanted."

The Entertainment Theater Industry

Theaters, like the LBO industry, had undergone tremendous changes over the past several decades. The current surge in attendance traced its roots back to the 1970s and the debut of big-budget, special-effects blockbusters such as *Jaws* and *Star Wars.* Old single-screen movie houses had given way to multiplexes with 12 to 14 screens and megaplex theater centers containing anywhere from 16 to 30 screens. Those multiplexes and megaplexes featured the latest in visual and audio technology plus motion simulation rides, virtual reality, video games, shops, restaurants, and coffee bars.

Theater owners traditionally rented a film based on a sliding scale, thereby giving the studios and distributors the largest percentage of gross receipts in the early weeks of a film's release and less in subsequent weeks. The exhibitor, in turn, might receive 10% of revenues during the first week, 20% during the second, and so forth. Longer runs therefore tended to be more profitable. In general, multiplexes and megaplexes had more clout than smaller theaters in negotiating with movie studios for the best new releases because of their greater viewing potential. Also as prime mall tenants, their size increased their ability to negotiate favorable leases.

About 70% of a theater chain's gross revenues were derived from box-office receipts—the remainder came from concessions. Yet concessions had a much higher profit margin than ticket sales. No surprise to frequent moviegoers, concession sales of soft drinks, popcorn, and candy had an 85% profit margin. One reason behind the trend toward building bigger and better

facilities was that multiplexes and megaplexes were believed to be more cost-effective to operate. Another reason was the increased number of movie releases, especially those regarded as potential blockbusters. Finally, there was intense competition for market share.

As the multiplex- and megaplex-building boom continued, it sparked a series of mergers and consolidations. Among the leaders in the multiplex and megaplex theater industry were Regal Cinemas, Loews Cineplex Entertainment, Carmike, Cinemark, and AMCE (**Exhibit 7**). Regal Cinemas became the country's largest theater chain in 1998 when it merged with the Act III chain. In 1997, Loews Theaters (the oldest theater circuit in North America) joined forces with Canada-based Cineplex Odeon Corporation to form Loews Cineplex Entertainment. The top 10 circuits owned 29% of the theaters but 53% of the screens in the United States.

In 2003, total U.S. box-office receipts grossed $9.49 billion and the number of admissions was 1.57 billion, marginally less than 1.63 billion in 2002 (**Exhibit 8**). Those figures represented a 74% and 21% increase, respectively, from 1995. Admissions were the highest since the late 1950s and had risen over the past 20 years despite the emergence of home entertainment. Ticket prices had also increased by 43% in the same period to an average of $6.21. Those features of the industry—the steady growth in attendance and ticket prices—had caught JPMP's attention.

On the other hand, JPMP was well aware that entertainment movies were volatile and hit-driven, like Hollywood itself, where fame was notoriously fleeting. The success of AMCE and other theater companies was highly dependent on the studios' ability to produce high-quality films and blockbuster hits, which drove attendance and revenues. A streak of unpopular films could impair attendance. Simply put—theaters had no control over their product—and that characteristic could make high leverage dangerous. Further, theaters had increasingly moved to combine movies with other entertainment, such as placing fine restaurants or retail establishments near or in theater complexes. All of that was done to enhance, in the industry parlance, the "butts-in-seats factor"—attendance—that drove ticket and concession revenue.

The strategy to combine movies with other entertainment, however, had increased the overall cost of a night out and market research suggested that saving money along with the "comfort of the couch" were the two factors most driving the growth in home entertainment.[10] And with home theater systems achieving ever higher standards of visual and audio quality, consumers were more apt to stay at home with a DVD, cable offering, or video game than incur the costs of a trip to the theater. Moreover, with so many entertainment offerings available, marketers found it increasingly difficult to convince consumers of a new release's significance and as a consequence, the time between a movie's first run in theaters and its release on DVD grew shorter. Other industry initiatives to grow revenue by selling ads ahead of the movie had also met with consumer resistance. As one unhappy moviegoer griped:

[10] "Home Theater Movie Watching at All-time High," http://www.audioholics.com/news/pressreleases/home theatermovies.php, 2 August 2004 (accessed 10 July 2006).

> You pay $8 for a ticket, then stand in a long line for the privilege of spending 10 more dollars on fake-buttered popcorn and over-iced soda. You finally settle into your seat, anticipating the thrills and chills of *Friday the 13th Part XVII*. The lights dim, and...What's this? A commercial! You paid almost 20 dollars to watch a commercial?"[11]

All in all, for the theater exhibition industry to advance, the movie-going experience had to evolve to offer a stronger value proposition beyond the content of the movie itself. But having moved so far in those other directions already raised questions of what was next for theaters and whether the long-run growth of the industry could be consistent with its historical performance.

AMCE

AMCE traced its roots to Edward Durwood, who opened the Durwood Theater in Kansas City, Missouri, in 1920. Edward's son, Stanley H. Durwood, joined his family's small but growing chain of Midwestern movie houses and drive-in theaters in 1945. He became president of Durwood Theaters in 1960 and continued experimenting with the concept of a multiple-screen theater. After trying several reconfigurations of existing spaces, Durwood created the first mall multiplex in 1963. In 1969, with a total of 68 screens, the company was incorporated as American Multi-Cinema, Inc., in honor of its signature facility, the multiplex.

In 1995, AMCE introduced the megaplex concept with the opening of The Grand 24 in Dallas, Texas, establishing stadium-style seating and top-of-the-line amenities. Through its aggressive expansion strategy, AMCE became the second-largest theater chain in the United States. Competitors quickly followed, leading to a proliferation of theaters and screens. The number of new theaters had an important but subtle effect on attendance growth, a key performance driver. Buildings did not drive attendance; movies drove attendance. Essentially attendance was a fixed pie and the number of theaters a utilization issue. A company's profits depended not only on the theaters it added but also on the number of theaters competitors added. Theaters placed in close proximity to another often could end up cannibalizing 20% of each other's revenues. Therefore, unless the building of new theaters was rational and limited to replacing older, declining theaters, the industry could tend toward "mutually assured destruction." As one commentator put it, "the problem was that theaters had been proliferating like bad guys in a Jackie Chan flick."[12] From 1995 to 1999, the number of indoor screens in the United States increased from 26,995 to 36,448, a 35% increase, while total industry attendance grew by only 17%, leading to a decline in attendance per screen (**Exhibit 8**). Although attendance and box-office revenues generally increased over that period, the costs of operating additional theaters had outpaced the increase in revenues for many theatrical exhibition

[11] See, for example, "Stop Pre-Movie Ads," at http://www.shinybluegrasshopper.com/nomovieads/ and http://www.captiveaudience.org.

[12] Dan Ackman in "Disaster of the Day: Movie Theaters," http://www.forbes.com, 23 January 2001 (accessed 10 July 2006).

companies. Excess screen capacity led to poor financial results and the bankruptcy filings of Regal, Loews Cineplex, and others.

Although AMCE did not file for bankruptcy protection, its management grew increasingly concerned that AMCE would be at a competitive disadvantage to other industry participants that had or would emerge from bankruptcy with reduced debt loads or favorably renegotiated leases. As a result, AMCE evaluated a number of alternatives intended to strengthen its balance sheet to compete effectively. In April 2001, it approved an investment of $250 million by Apollo Management, L.P., and used the funds to pursue restructuring and acquisition opportunities in a consolidating industry environment.

In 2004, AMCE operated 231 theaters with more than 3,500 screens, giving it the most screens per theater in the United States (**Exhibit 7**). Seventy-four percent of AMCE's properties were megaplexes (defined as having 14 or more screens per theater) and 22% were multiplexes with an average of 15.3 screens per theater. AMCE had a modern theater circuit and thus a higher asset quality than its competitors, highly productive theaters in terms of revenue and contribution per theater, and broad market coverage. Seventy-three percent of AMCE's theaters were located in the top-50 DMAs (Designated Market Areas—defined by population and income data), highlighting the company's focus on highly profitable markets. AMCE's cash flows had improved and strengthened in the recent past. In the fiscal year ending March 2004, AMCE realized the highest sales in its history, $1,782.8 million, and had adjusted EBITDA of $253.3 million. AMCE's revenues (including several acquisitions) had grown at a cumulative average growth rate (CAGR) of 13% from 1992 to 2004 and adjusted EBITDA grew at a CAGR of 16% over the same period. Selected financial and operational data are shown in **Exhibits 9, 10,** and **11.**

Despite all of the recent promising signs, AMCE reported net income of −$16.2 million in a year in which it had achieved record sales. And, while industry observers believed that the recently improved results were a sign that the problems of excess capacity were waning, could JPMP be sure?

The Buyout Proposal

Between Apollo's investment and JPMP's expression of interest in April 2004, management considered a number of potential acquisitions. AMCE completed three acquisitions of theater circuits during this time and evaluated a number of other transactions, including a combination with Loews Cineplex. Loews Cineplex, which emerged from bankruptcy protection in March 2002, was identified by AMCE as an attractive strategic transaction. As late as January 2004, AMCE had pursued discussions with Loews Cineplex regarding a possible deal, but no agreement could be reached. In March 2004, Cinemark, Inc. sold a majority of its capital stock to Madison Dearborn Partners, a private equity firm, for approximately $1.5 billion. During the sale process, AMCE's management considered pursuing Cinemark, but ultimately decided against it.

Along with evaluating its strategic options, AMCE became increasingly convinced that the firm's complicated share structure made potential acquisitions more difficult. The overhang of noncommon shares accounted for roughly 52% of AMCE's shares on a fully diluted basis. In February 2004, the firm contemplated a recapitalization designed to simplify AMCE's ownership structure by converting the company's outstanding Series A and Class B shares into a single class of common stock. An independent committee of the board evaluated several recapitalization proposals but ultimately failed to agree on any.

JPMP was aware of AMCE's recent activities and following the April 30 conversation with Brown, it sought to formulate the terms of an offer. **Exhibit 11** contains JPMP's projections for the buyout. JPMP saw the primary benefits of the buyout resulting from historically steady industry growth, continued ticket price increases, growth in attendance and ancillary revenues, and slowly improved operating margins.[13] Industry peers also traded at multiples above AMCE, suggesting that given AMCE's high quality assets and operations, the company could trade higher in the long term if well managed. **Exhibit 12** details the stock price history of AMCE and its peers and **Exhibit 13** provides information on market multiples and comparable transactions.

Financing Plan

JPMP intended to fund the amount to be paid to AMCE's shareholders from a combination of $333 million in cash, debt, and equity financing. It had sought assurances from lenders on the level of new debt financing that might be available to finance the buyout. At the firm's current price of around $16 per share, lenders were willing to commit a total of $625 million of new debt financing. The $625 million would be made up of: (1) the proceeds of $169.9 million in notes which would be contributed by Marquee Holdings, the holding company, as equity to AMCE, (2) the proceeds of a $250 million senior fixed-rate note offering due 2012, and (3) a $205 million senior floating-rate note offering due 2010. Though that commitment depended to some extent on the premium paid, large changes in the loan commitment were not anticipated. Discussions with management indicated that $686.4 million of AMCE's existing debt would not need to be refinanced and would remain on the books following a deal. In addition, fees of $80 million were expected to be paid to complete the transaction. **Exhibit 14** summarizes the cash and debt financing for the deal with the remainder to be made up by equity contributed from the sponsors.[14]

Any deal proposed by JPMP would have to address the board's desire to simplify AMCE's share structure. That meant not only would JPMP have to repurchase the firm's 34.0 million outstanding common shares but also 299,477 Series A preferred shares held by Apollo

[13] JPMP planned to improve Adjusted EBITDA margins from 2004 to 2009. This would be accomplished by the continued climb in ticket prices and a reduction in general and administrative expenses. Ancillary revenues from other theater operations were expected to increase some $30 million annually by 2009. There would also be continued efforts to optimize the theater portfolio—to build and acquire better-performing theaters and dispose of underperforming ones.

[14] The financing plan also called for a $175 million amended credit facility; however, no borrowings were currently outstanding on the line of credit.

and 3.05 million convertible Class B shares held by the Durwood Trust. Apollo's preferred shares would convert into 42.7 million common shares and Durwood's Class B shares would convert on a one-to-one basis into common shares. When other executive and employee shares and in-the-money stock options were included, JPMP's buyout proposal would require the repurchase of a total of 86.4 million shares.[15]

Decision

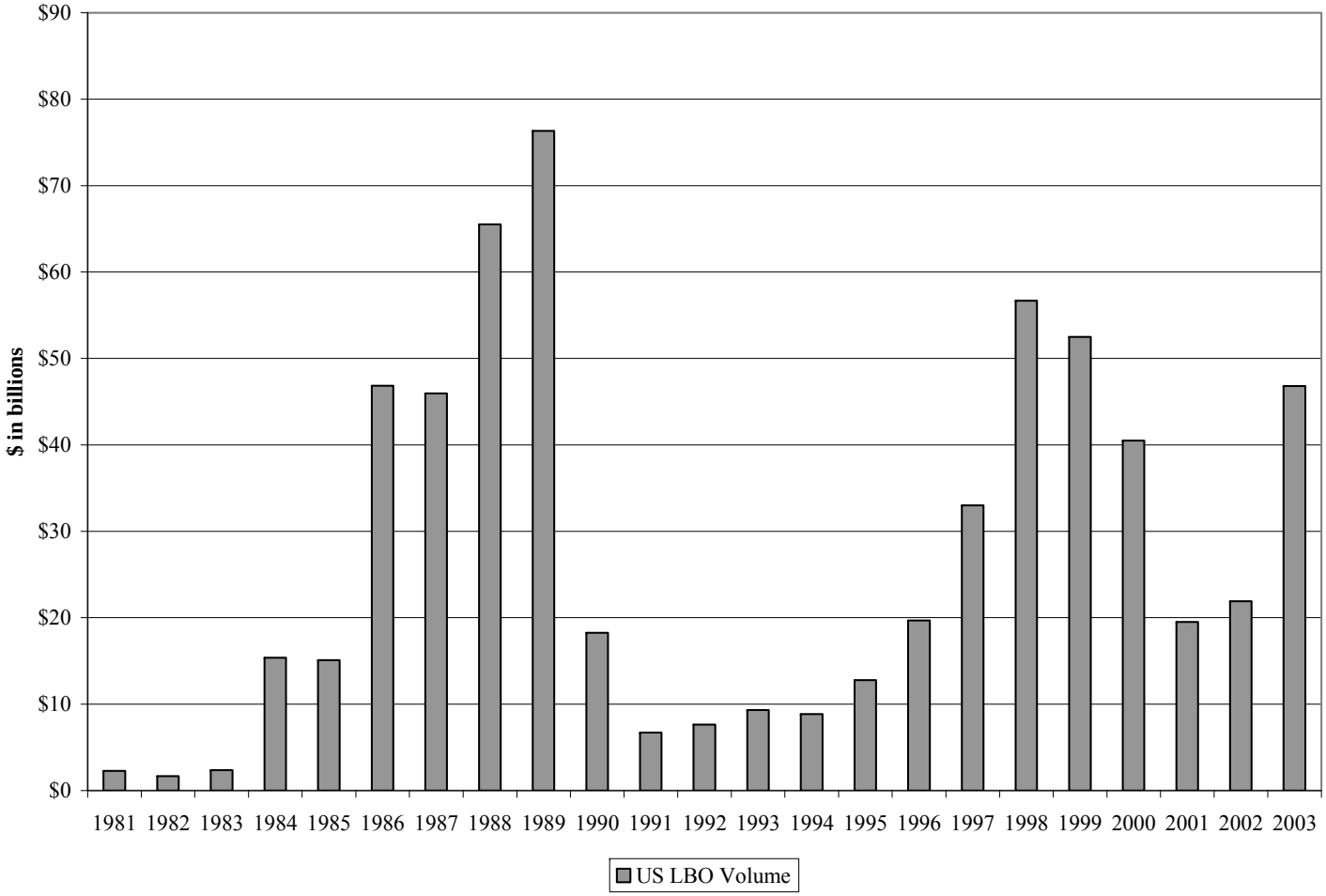
JPMP faced an important decision. What price should it offer for an outright buyout of AMCE? If Apollo sold out entirely, it needed to consider the implications of acquiring AMCE from them—a private equity fund just like JPMP but one more interested in selling than buying. While "buyouts of buyouts" had grown increasingly common in recent years due to the heightened presence of private equity funds in M&A activity, they raised some potential concerns. First was the issue of what the seller, Apollo, knew that the buyer, JPMP, did not. JPMP acknowledged that Apollo was a shrewd operator and wondered what signal Apollo's departure might send to the debt market. Second was the issue of whether there was enough opportunity left in AMCE following years of steady growth for JPMP to achieve its target return. If, on the other hand, Apollo could be persuaded to reinvest in the deal, JPMP would have to determine how low a price would be needed to interest Apollo and how high a price would be needed to meet the board's demands. Further, JPMP would have to become comfortable with Apollo as a partner and decide on the split of equity ownership between the two. That course would reduce the funding costs to JPMP and improve the certainty of obtaining adequate financing on acceptable terms. But whether all these issues could be resolved and JPMP could still make its targeted return of 20% to 25% remained to be seen.

[15] Whether or not Apollo chose to reinvest in the new deal, all of its Series A preferred shares would be repurchased under the buyout proposal. The proceeds would be paid to the limited partners in Apollo's earlier raised funds. Any new money invested by Apollo in AMCE would come from more recently raised funds.

Exhibit 1

THE BUYOUT OF AMC ENTERTAINMENT

Total U.S. Leveraged Buyout Volume, 1980–2003

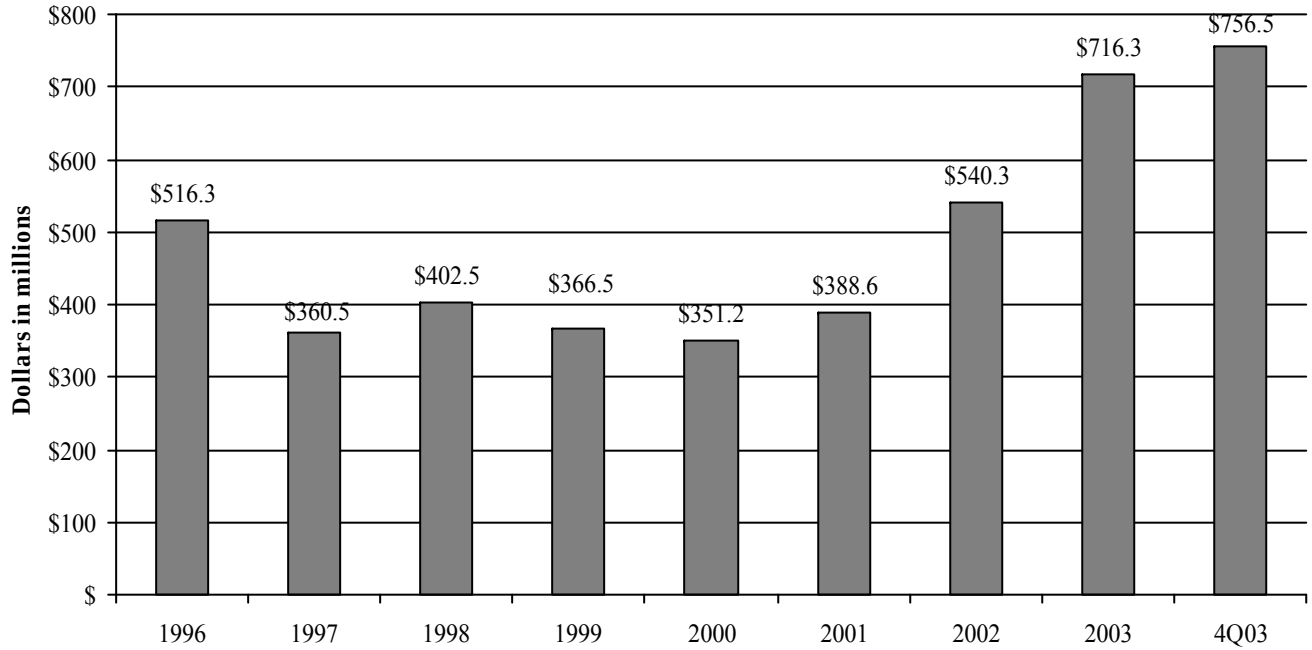


Source: Thomson Financial and Standard and Poor's, Inc.

Exhibit 2

THE BUYOUT OF AMC ENTERTAINMENT

Average LBO Transaction Value, 1996–4Q03

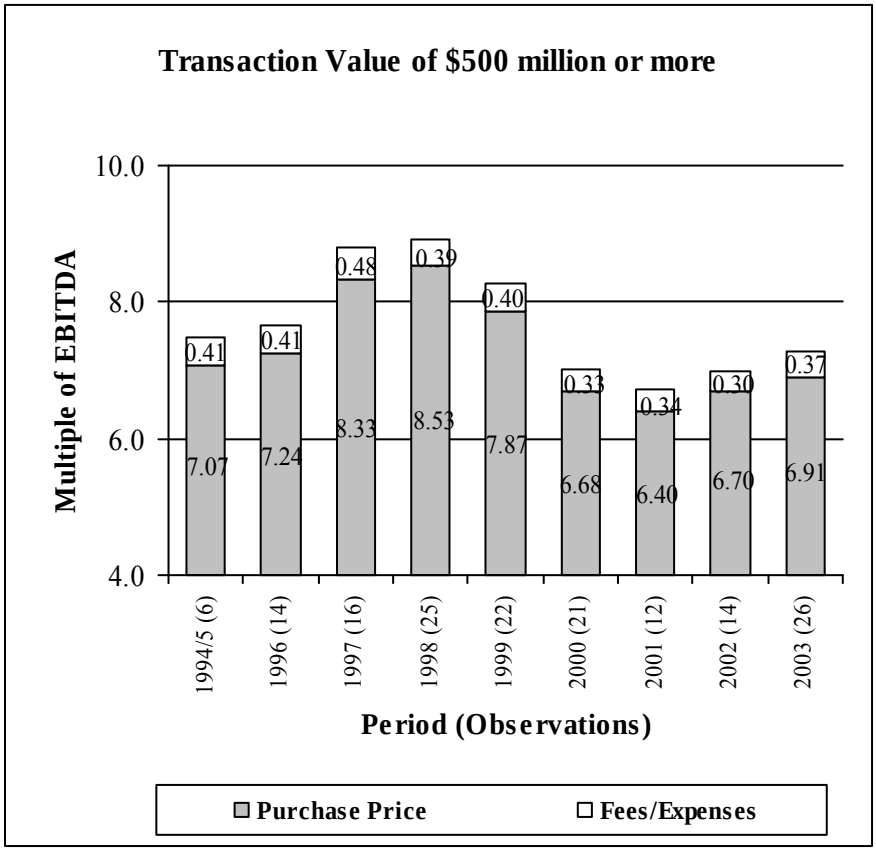


Source: Standard and Poor's, Inc.

Exhibit 3

THE BUYOUT OF AMC ENTERTAINMENT

Average LBO Transaction Value as a Multiple of Nonadjusted Pro Forma Trailing EBITDA
1994/5–2003

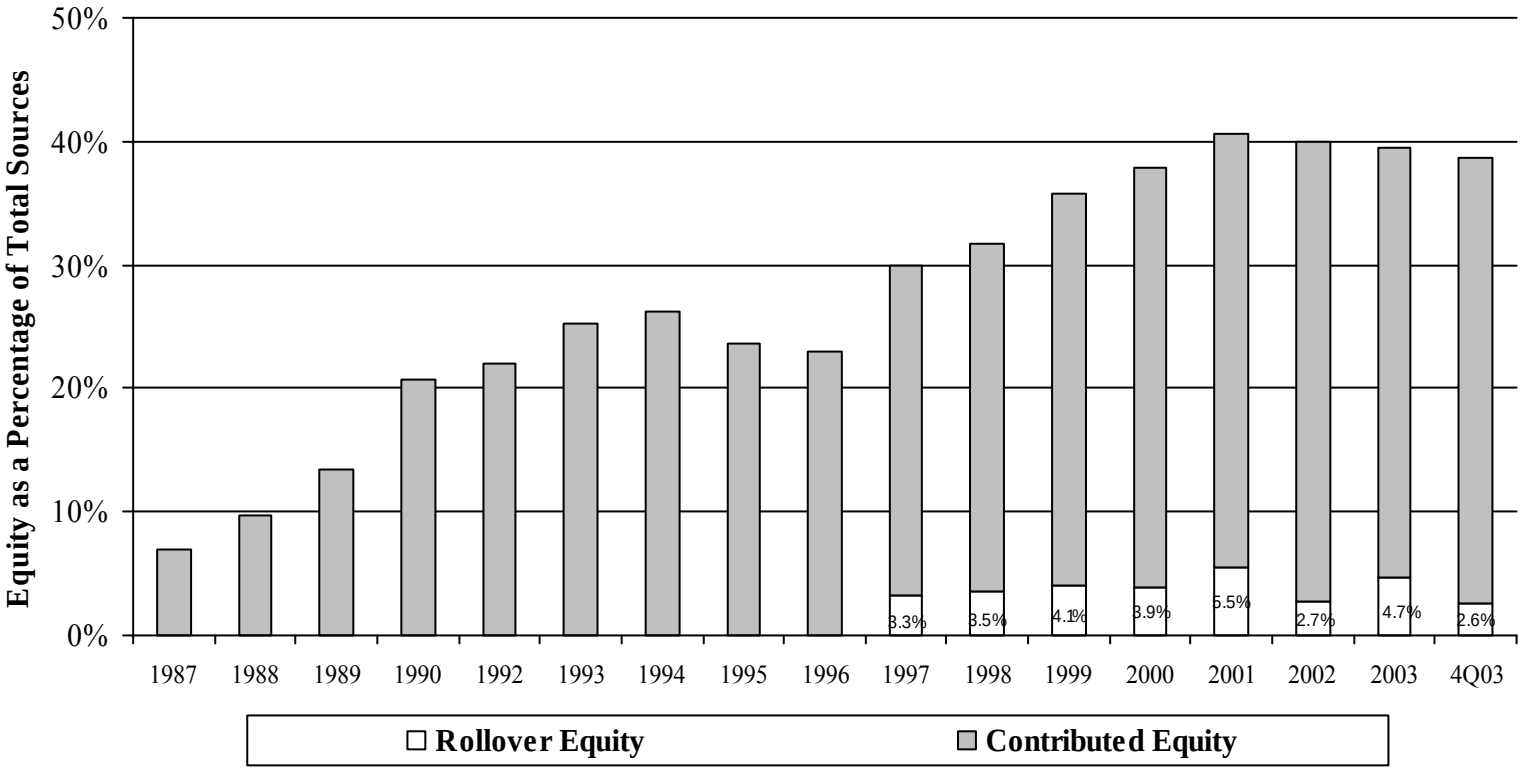


Source: Standard and Poor's, Inc.

Exhibit 4

THE BUYOUT OF AMC ENTERTAINMENT

Average Equity Contributions to Buyouts, 1987–2003



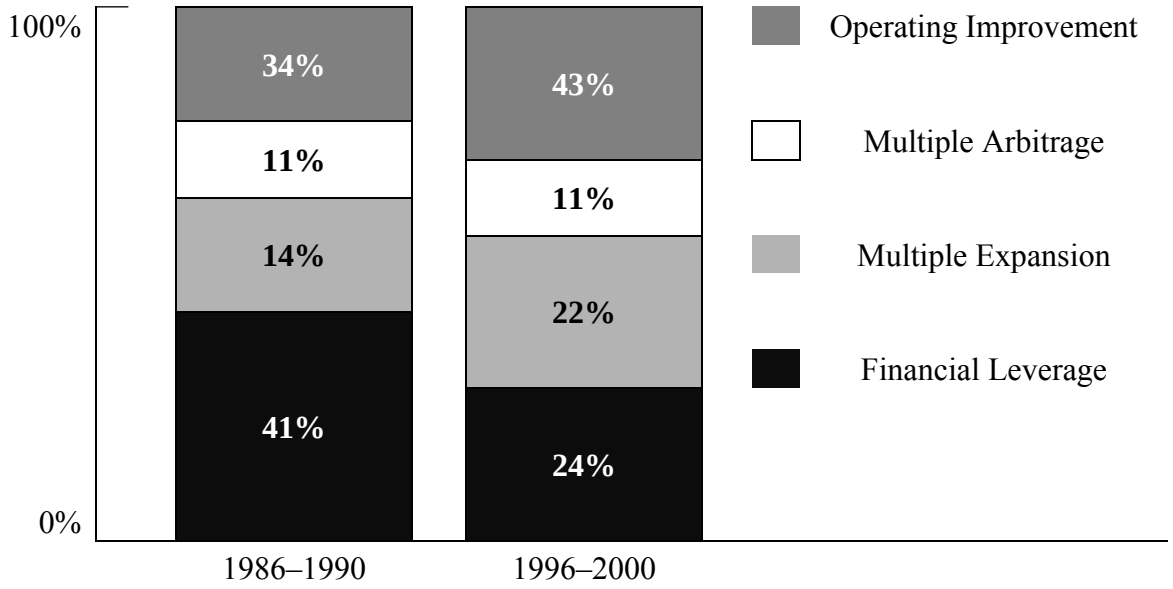
Equity includes common equity and preferred stock as well as holding company debt and seller note proceeds downstream to the operating company as common equity. Rollover equity prior to 1996 is not available. There were too few deals in 1991 to form a meaningful sample.

Source: Standard & Poor's, Inc.

Exhibit 5

THE BUYOUT OF AMC ENTERTAINMENT

Components of Sources of Return, 1986–90 vs. 1996–2000



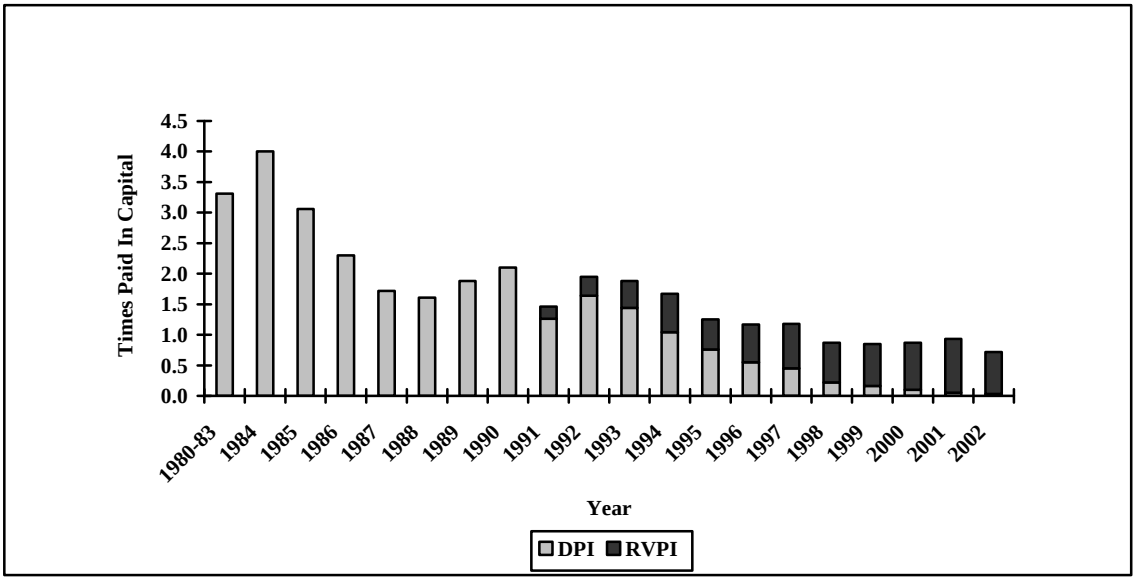
Multiple expansion was industrywide growth or cyclical expansion.
Multiple arbitrage was deal-specific differences between the purchase price and sale (exit) multiples.

Source: General Partner Survey, Asset Alternatives, 2001.

Exhibit 6

THE BUYOUT OF AMC ENTERTAINMENT

Investment Multiples on U.S. Buyout Funds: 1980–2003



DPI (also referred to as the Realization Ratio) is a measure of how much of a fund's return had actually been returned (distributed) to investors.

RVPI is a measure of how much of a fund's return was unrealized and not yet distributed to investors.

Times Paid in Capital (also referred to as the Investment Multiple) is the sum of the DPI and RVPI and represents the total return to investment.

Exhibit 7

THE BUYOUT OF AMC ENTERTAINMENT

Top 10 Theater Circuits in the United States*

	Headquarters	Screens	Theaters	Average Screens Per Theaters	Revenue per screen (in thousands)
Regal Entertainment Group	Knoxville, TN	6,076	547	11	$282
AMC Entertainment Inc.	Kansas City, MO	3,316	218	15	$370
Cinemark USA, Inc.	Plano, TX	2,329	201	12	$232
Carmike Cinemas, Inc.	Columbus, GA	2,221	291	8	$158
Loews Cineplex Entertainment Corp.	New York, NY	1,463	140	10	$409
National Amusements Inc.	Dedham, MA	1,101	94	12	
Century Theatres	San Rafael, CA	919	79	12	
Famous Players Inc.	Toronto, Ontario	800	80	10	
Kerasotes Theatres	Chicago, IL	532	77	7	
Marcus Theatres Corporation	Milwaukee, WI	488	46	11	
Total/Average		19,245	1,773		$262

* As of June 1, 2004.

Source: National Association of Theater Owners.

Exhibit 8

THE BUYOUT OF AMC ENTERTAINMENT

Trends in the U.S. Entertainment Theater Industry

Year	**1946**	**1955**	**1960**	**1965**	**1975**	**1980**	**1985**	**1990**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**
U.S. box office gross ($ billion)	1.69	1.20	0.98	1.04	2.11	2.75	3.75	5.02	5.49	5.91	6.37	6.95	7.45	7.67	8.41	9.52	9.49
Admissions (billion)	4.07	2.07	1.3	1.03	1.03	1.02	1.05	1.19	1.26	1.34	1.39	1.48	1.47	1.42	1.49	1.63	1.57
Average ticket prices ($)	0.42	0.58	0.76	1.01	2.05	2.69	3.55	4.23	4.35	4.42	4.59	4.69	5.06	5.39	5.65	5.8	6.03
Movie Screens																	
Indoor						14,029	18,327	22,774	26,995	28,905	31,050	33,418	36,448	35,567	34,490	35,170	35,361
Drive-in						3,561	2,820	915	848	826	815	750	683	683	683	666	634
Total						17,590	21,147	23,689	27,843	29,731	31,865	34,168	37,131	36,250	35,173	35,836	35,995
Theaters																	
Indoor									7,151	7,215	6,903	6,894	7,031	6,550	5,813	5,712	5,700
Drive-in									593	583	577	524	446	442	440	432	400
Total									7,744	7,798	7,480	7,418	7,477	6,992	6,253	6,144	6,100
Admissions per screen (thousands per annum)						58.0	49.7	50.2	45.3	45.1	43.6	43.3	39.6	39.2	42.4	45.5	43.6

Source: National Association of Theater Owners.

Exhibit 9

THE BUYOUT OF AMC ENTERTAINMENT

Balance Sheet for AMCE

Years ended	March 28, 2002	April 3, 2003	April 1, 2004
Cash	$219,432	$244,412	$333,248
Accounts receivable, net	24,195	27,545	39,812
Inventories	0	0	0
Other current assets	48,416	50,732	62,676
Total current assets	$292,043	$322,689	$435,736
PP&E, net	776,113	856,463	777,277
Definite life intangibles	5,369	30,050	23,918
Indefinite life intangibles	0	0	0
Goodwill	30,276	60,698	71,727
Deferred income taxes	127,115	160,152	143,944
Other long-term assets	48,254	50,646	53,932
Investments in and receivables from affiliates	0	0	0
Total assets	$1,279,170	$1,480,698	$1,506,534
Accounts payable	$110,993	$116,269	$107,234
Accrued liabilities	136,196	112,217	112,386
Other current liabilities	2,627	69,741	78,879
Total current liabilities	$249,816	$298,227	$298,499
Corporate borrowings			
9 1/2 % senior subordinated notes due 2009		200,000	0
9 1/2 % senior subordinated notes due 2011		297,880	214,474
9 7/8 % senior subordinated notes due 2012		175,000	175,000
8 % senior subordinated notes due 2014			300,000
Discount on senior subordinated notes		(4,219)	(3,043)
Long-term debt	$596,540	$668,661	$686,431
Capital and financing lease obligations	54,429	56,536	58,533
Other long-term liabilities	120,029	177,555	182,467
Total liabilities	$1,020,814	$1,200,979	$1,225,930
Total equity	258,356	279,719	280,604
Total liabilities and equity	$1,279,170	$1,480,698	$1,506,534
Selected cash flow items			
Net cash provided by operating activities	101,091	128,747	183,278
Net cash used in investing activities	(144,510)	(137,201)	(69,378)
Net cash provided by (used in) financing activities	228,879	33,437	(24,613)
Other data:			
Capital expenditures	(82,762)	(100,932)	(95,011)
Proceeds from sale/leasebacks	7,486	43,665	63,911

Exhibit 10

THE BUYOUT OF AMC ENTERTAINMENT

Characteristics of AMCE's Theater Operations

Operating data at year end	2002	2003	2004
Screen additions	146	95	114
Screen acquisitions	68	641	48
Screen dispositions	86	111	142
Average screens	2,786	3,498	3,494
Attendance (in thousands)	158,241	197,363	186,989
Number of screens operated	2,899	3,524	3,544
Number of theatres operated	181	239	232
Screens per theatre	16	14.7	15.3

	2004	
AMCE screen portfolio	**Number of screens**	
Megaplexes (North American and international)	2,613	74%
Continuing multiplexes	779	22%
Disposition multiplexes	152	4%
Total screens	3,544	100%

AMCE megaplex performance	**Megaplex**	**Multiplex**	**Difference**
Attendance per screen (000s)	59.90	41.30	45%
Revenues per head ($)	9.47	8.95	6%
ROI	27%	18%	50%

Exhibit 11

THE BUYOUT OF AMC ENTERTAINMENT

Projections for AMC Entertainment Inc.

Dollars in thousands, except per share

		Historical year ending Apr 01,			Projected year ending Apr 01,				
		2002	2003	2004	2005	2006	2007	2008	2009
Admissions		$898,040	$1,212,204	$1,219,393	$1,255,975	$1,293,654	$1,332,464	$1,372,438	$1,413,611
Concessions		$358,107	$468,578	$456,990	$472,985	$489,539	$506,673	$524,407	$542,761
Other theater		$39,972	$48,600	$53,983	$59,381	$65,319	$71,851	$79,037	$86,940
NCN and other		$41,768	$55,693	$52,454	$52,979	$53,508	$54,043	$54,584	$55,130
Total Revenues[1]		$1,337,887	$1,785,075	$1,782,820	$1,841,319	$1,902,021	$1,965,031	$2,030,464	$2,098,441
Film exhibition costs		$485,799	$660,982	$649,380	$655,874	$662,433	$669,057	$675,747	$682,505
Concession costs		$42,201	$54,912	$51,259	$53,822	$56,513	$59,339	$62,306	$65,421
Theater operating expense		$329,298	$438,605	$419,619	$432,208	$443,013	$451,873	$458,651	$465,531
Rent		$234,769	$300,377	$314,024	$332,865	$349,509	$366,984	$385,333	$404,600
NCN and other		$45,264	$52,444	$46,847	$47,784	$48,740	$49,714	$50,709	$51,723
Preopening expense		$4,363	$3,227	$3,858	$4,437	$5,102	$5,868	$6,748	$7,760
Cost of products & services (excl depreciation)		$1,141,694	$1,510,547	$1,484,987	$1,526,989	$1,565,309	$1,602,835	$1,639,494	$1,677,539
Gross profit		$196,193	$274,528	$297,833	$314,330	$336,712	$362,197	$390,971	$420,902
Theater and other closure expense		$2,124	$5,416	$4,068	$64,560	$66,619	$68,777	$71,041	$73,423
Administrative & general (excl amortization)		$37,780	$68,104	$62,591	$120,560	$66,571	$68,776	$71,066	$73,445
EBITDA		$156,289	$201,008	$231,174	$129,210	$203,522	$224,644	$248,863	$274,033
Adjustments									
Add back: Nonrecurring M&A costs				$5,500	$65,000				
Add back: Preopening expense		$4,363	$3,227	$3,858	$4,437	$5,102	$5,868	$6,748	$7,760
Add back: Theatre and other closure expense		$2,124	$5,416	$4,068	$64,560	$66,619	$68,777	$71,041	$73,423
Add back: Stock-based compensation and other		$442	$21,261	$8,727					
Adjusted EBITDA		$163,218	$230,912	$253,327	$263,207	$275,243	$299,288	$326,652	$355,216
Depreciation & amortization		$99,022	$126,994	$124,572	$132,046	$139,969	$148,367	$157,269	$166,705
Impairment and disposition of assets		($1,821)	$18,178	$13,682					
EBIT		$66,017	$85,740	$115,073	$131,161	$135,274	$150,921	$169,383	$188,511
Taxes[2]	0.41	$2,700	$10,000	$11,000	$53,776	$55,462	$61,878	$69,447	$77,289
NOPAT		$63,317	$75,740	$104,073	$77,385	$79,812	$89,043	$99,936	$111,221

[1] Admissions are assumed to grow at 3.0% per annum and concessions are assumed to grow at 3.5% per annum, in line with historical experience.
[2] Taxes for 2002–2004 are those actually reported. Projected Tax Rate of 41% is based on U.S. federal, state, and local taxes.

Exhibit 11 (continued)

Projections for AMC Entertainment Inc.

	Historical year ending Apr 01,			Projected year ending Apr 01,				
	2002	2003	2004	2005	2006	2007	2008	2009
NOPAT	$63,317	$75,740	$104,073	$77,385	$79,812	$89,043	$99,936	$111,221
Add:								
Depreciation & amortization	$99,022	$126,994	$124,572	$132,046	$139,969	$148,367	$157,269	$166,705
Less:								
Capital expenditures[3]	$82,762	$100,932	$95,011	$70,000	$70,000	$70,000	$70,000	$70,000
Increases in working capital		($42,745)	($23,939)	$3,143	$4,212	$3,932	$3,631	$3,765
Total Free Cash Flow to Capital				**$136,288**	**$145,568**	**$163,479**	**$183,574**	**$204,162**

Debt Financing and Interest Expense[4]

Dollars in thousands, except per share

	2005	2006	2007	2008	2009
Pre-LBO Debt					
$213.8 million 9.5% senior subordinated notes due 2011	($20,311)	($20,311)	($20,311)	($20,311)	($20,311)
$172.6 million 9 7/8% senior subordinated notes due 2012	($17,044)	($17,044)	($17,044)	($17,044)	($17,044)
$300.0 million 8% senior subordinated notes due 2014	($24,000)	($24,000)	($24,000)	($24,000)	($24,000)
New Debt (Post LBO)					
$250.0 million Marquee 8 5/8 % senior notes due 2012	($21,563)	($21,563)	($21,563)	($21,563)	($21,563)
$205.0 million Marquee senior floating rate notes due 2010 (currently 5.91%)	($12,116)	($12,116)	($12,116)	($12,116)	($12,116)
$169.9 million Marquee holding company notes[5]	0.0	0.0	0.0	0.0	0.0
Total interest expense	**($95,033)**	**($95,033)**	**($95,033)**	**($95,033)**	**($95,033)**

Source: Projections are developed from public disclosures filed with the SEC in connection with the transaction.

[3] Capital expenditures and new theaters to be added were based on JPMP's projections.

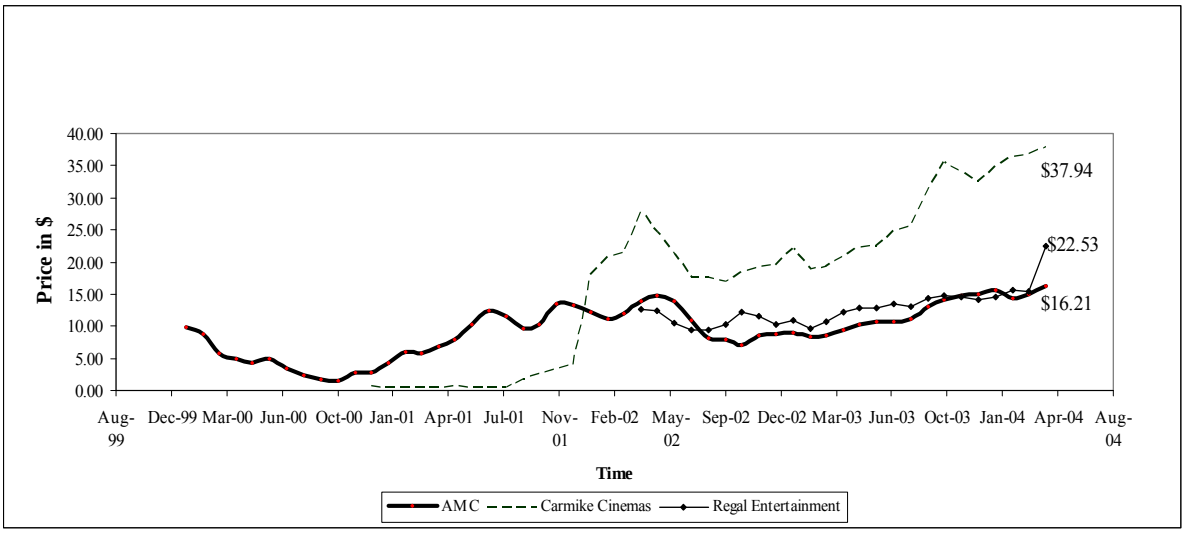
[4] Existing and post-LBO debt financings are nonamortizing and payable in full on maturity. Pre-LBO debt is outstanding as of July 2004. From FYE 2003 through July 2004, the company had chosen to pay down some of the existing senior subordinated notes but was not required to under the terms of the debt.

[5] Unless Marquee Holdings elects to pay cash interest, the interest on the notes will accrete from the date of issuance of the notes at the annual rate of 12% until August 15, 2009, compounded semiannually to an aggregate principal of $1,000 per note for a total of $304 million.

Exhibit 12

THE BUYOUT OF AMC ENTERTAINMENT

Stock Price History of AMCE and its Peers



Carmike (CKEC) started trading in January 2001.
Following its emergence from Chapter 11, Regal Entertainment (RGC) started trading in May 2002.

Capital Market Information:

AMCE beta coefficient = 1.15

10-Year U.S. Treasury rate (July 2004) = 4.50%

Exhibit 13

THE BUYOUT OF AMC ENTERTAINMENT

Market Multiples of Industry Peers and Comparable Transactions

Market Multiples

	Regal	Carmike	AMCE
Enterprise value as multiple of:			
Revenue			
2003 Actual	1.77×	1.46×	0.89×
Latest 12 months	1.76×	1.42×	0.89×
EBITDA			
2003 Actual	8.1×	7.4×	6.5×
Latest 12 months	8.3×	6.9×	6.4×

Comparable Transactions

Announcement date	Acquirer	Target	Value ($ millions)
June 2004	Bain Capital, Carlyle Group, Spectrum Equity	Loews Cineplex	$2,000
March 2004	Madison Dearborn Partners	Cinemark USA	$1,390
February 2003	Regal Entertainment Group	Hoyts Cinemas	$196
April 2002	Loews Cineplex	Star Theaters	$69
March 2002	AMCE	Gulf States Theaters	$46

Selected Multiples for the Above Transactions

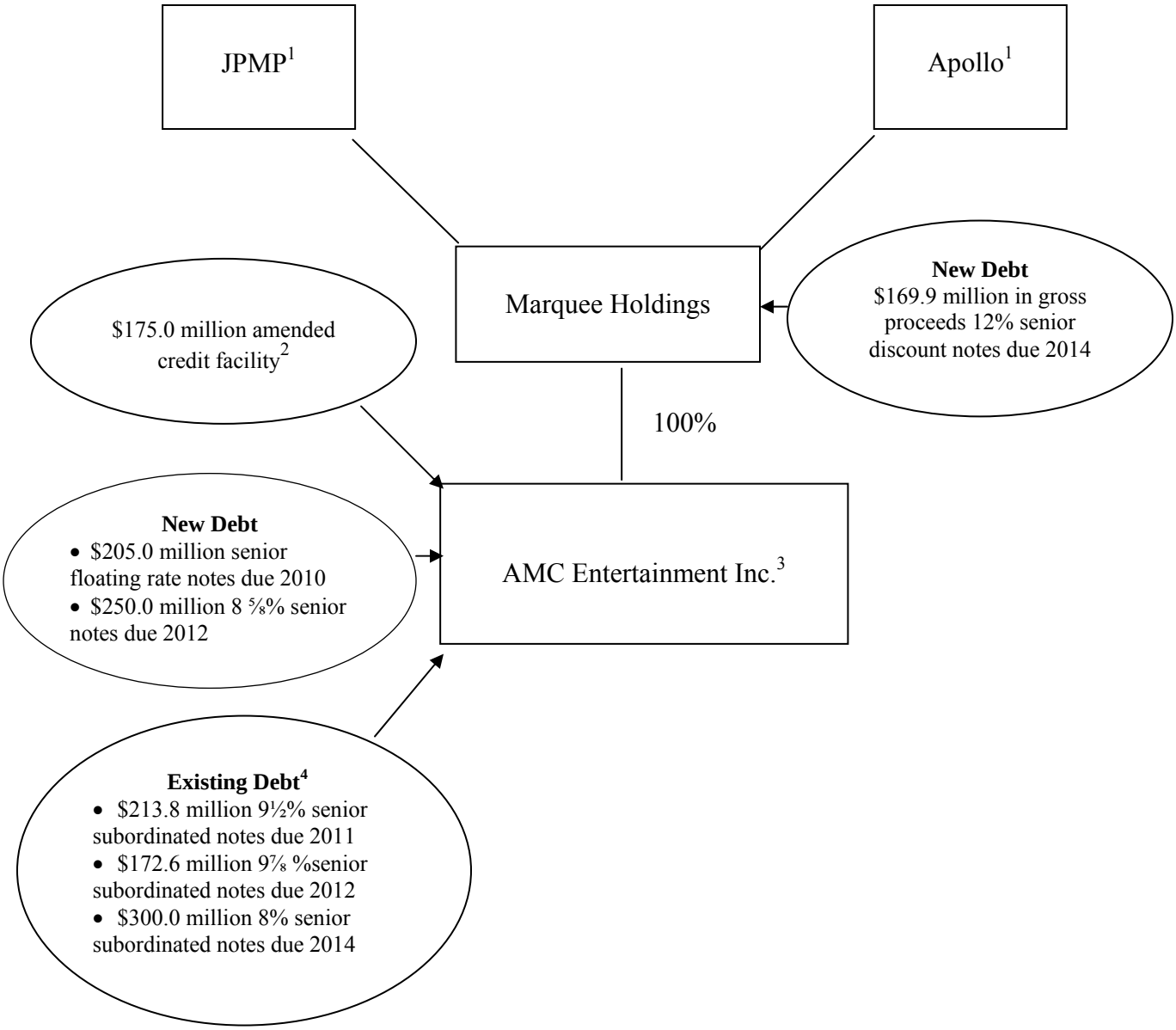
Transaction value as a multiple of:	Sales	EBITDA	EBITDAR*
High	2.93×	7.5×	7.7×
Average	1.66×	6.4×	7.0×
Median	1.57×	6.5×	7.0×
Low	1.10×	5.2×	6.4×

*EBITDAR: Earnings before interest, depreciation and amortization, and rent

Exhibit 14

THE BUYOUT OF AMC ENTERTAINMENT

The Proposed Financing for the Transaction



[1] JPMP and Apollo would provide the outstanding common stock of holdings and control the boards of directors of holdings and the company.

[2] There were no borrowings currently outstanding on the amended credit facility.

[3] It was assumed that $333 million of AMCE's cash on hand would be used to finance the transaction. Fees of $80 million were expected to be paid to complete the transaction.

[4] Existing debt outstanding as of July 2004.