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Cinemark protects shareholders while tapping into convertible bond bonanza

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PROPRIETARY
North America

Leisure
USA

Issuer
Cinemark Holdings, Inc

Proceeds from Cinemark's USD 400m convertible bond issued last week will buttress the company's liquidity while also protecting shareholders from dilution, said two equity analysts and two buyside analysts.

The Texas-based movie theater operator used USD 46m in bond proceeds for a convertible hedge that synthetically raises the USD 14.35 strike price of the convertible notes to USD 22.08, said the two buysiders.

Achieving that kind of share performance in the near-term is unlikely considering the continuing uncertainty of coronavirus-related shutdown of the leisure industry, said the equity analysts. But five years out on the time horizon is a different story – and with the hedge on the converts, the company is making a down payment on a rebound in its share performance.

"The company is paying today to receive the potential stock appreciation in the future," said Bethany Knight, a director at Riverside Risk Advisors with extensive experience in the equity derivatives and equity-linked origination market on Wall Street.

Given the stock price at the time of the converts issuance, roughly USD 11.00, the strike price at just more than USD 14.00 represented a 30% premium. But a strike price that represents a 100% premium is out of the money for many investors.

"If [Cinemark] could have issued a convert up 100% for a strike of ~USD 22.00, they would have done that," said Knight. "But there is no market for a convertible with a 100% strike. The call spread is a way to keep the conversion premium low to the public market, and synthetically increase the strike price through this private transaction."

The hedging transaction has no bearing on convertible bond investors and their own thesis for investing in the company, said the two buysiders. The only effect the hedge might have on bondholders is the confidence that the company can use a portion of bond proceeds to protect shareholders from what the company believes is inevitable dilution, said the buysiders.

"A company that has the convertible hedge is generally in a situation where they don't need the money, but want to create confidence in the market and the terms [of the capital] are cheap," said one of the buyside analysts.

Cinemark's stock has traded up since the issuance, gaining 10% yesterday to close at USD 13.65 (USD 1.6bn market cap), from a USD 11.15 open last week when the company issued the converts. The USD 400m 4.5% convertible bond due 2025 traded up to 111 yesterday to yield 1.9% – a surge from 101.5 to yield 4.1% on 19 August when the bonds broke for trading, according to MarketAxess.

Cinemark issued the bonds not long after it reported 2Q20 earnings in which quarterly revenue all but evaporated, coming in at USD 8.9m compared to USD 957m in 2Q19. The company incurred a USD 170m net loss in 2Q20 down from net income of USD 101m year over year. EBITDA for the quarter swung to a negative USD 117m, from positive USD 244m last year.

Convertible surge

Traditionally, companies that issue convertible bonds are in high growth mode or are financing mergers and acquisitions. But since April of this year, rescue capital for financially strong companies has been the primary reason for convertible popularity, said the two buysiders.

ICE BofA All US Convertible Index returned 15.03% year-to-date as of 31 July, beating out the S&P 500's 2.38% return and the Russell 2000 Index's 10.5% loss over the same period, according to a 31 July US Convertible Market Snapshot published by Calamos Investments.

Total convertible bond issuance so far this year is USD 70bn, and if the same pace continues for the remainder of the year, issuance would be a record USD 120bn. Over the past 10 years, 2019 had the most new issuance at USD 53bn, according to the report.

For well-performing companies that have been especially exposed to the pandemic – such as movie theaters and cruise lines – convertibles put cash on the balance sheet, and keep the cost of capital low while providing investors an option for equity-like returns once the economy recovers.

Cinemark Capital Stack

Pro Forma Cinemark Holdings Capital Structure						Face				Market		
USD (m)	Maturity	Springing Maturity	Coupon	Price	Yield	Principal	Adjustment	Adj Principal	Leverage (LTM)	Value	Leverage (LTM)	Int Expense
Revolver[1]	28-Nov-22		L+[1.5% - 2.25%]	-	-	99	(99)	-	0.0x	-	0.0x	0
Term Loan[1]	29-Mar-25		L+1.75%	88	6.4%	643	-	643	2.2x	567	1.9x	22
Senior Notes[2]	1-May-25	14-Sep-22	8.750%	100	8.7%	250	-	250	3.0x	250	2.8x	22
Senior Convertible Notes[3]	15-Aug-25		4.500%	100	4.5%	-	400	400	4.4x	400	4.1x	18
Senior Notes	15-Dec-22		5.125%	92	9.3%	400	-	400	5.7x	366	5.3x	21
Senior Notes	1-Jun-23		4.875%	90	9.0%	755	-	755	8.3x	680	7.6x	37
Other Debt[4]	-		*Various*	-	-	6	-	6	8.3x	6	7.6x	-
Total Debt						**2,153**		**2,454**	**8.3x**	**2,268**	**7.6x**	**119**
Less: Cash[5]						572	255	827		827		
Net Debt						**1,581**		**1,627**	**5.5x**	**1,441**	**4.9x**	
Plus: Noncontrolling Interests						12	-	12		12		
Less: Equity Investments						(390)		(390)		(390)		
Plus: Cinemark Holdings Market Cap (NYSE: $CNK)				USD 12.47/share		1,467	-	1,467		1,467		
Enterprise Value (EV)						**2,671**		**2,716**	**9.2x**	**2,530**	**8.5x**	

Source: Company Filings, Debtwire, Bondticker, Markit

Memo	
LTM Adj EBITDA	297
NTME Adj EBITDA	118
NTM Net Leverage - Face	13.4x
NTM Net Leverage - Market	13.8x
Common Shares Outstanding (m)	118
Finance Lease Obligations	5

Pro Forma Liquidity	
Cash & Cash Equivalents	572
Revolver Availability	1
30 June 2020 Liquidity	**573**
Cash Proceeds from Convertible Notes[5]	255
NTME EBITDA	118
NTM Cash Interest	(119)
NTM CapEx	(108)
NTM Term Loan Amortization	(6)
Liquidity on 30 June 2021	**713**

Notes

1. Secured by mortgages on certain fee and leasehold properties and security interests in substantially all of Cinemark USA, Inc.'s and the guarantors' personal property.
2. If the 5.125% senior notes have a balance of greater than USD 50m on 13 September 2022, these 8.750% notes will mature on 14 September 2022. Additionally, if the balance on the 4.875% senior notes exceeds USD 50m on 27 February 2023, these 8.750% notes will mature on 28 February 2023.
3. Cinemark priced USD 400m of convertible senior notes on 19 August 2020. The initial purchasers also have a 13-day period to purchase an additional USD 60m of notes. The initial conversion rate will be 69.6767 shares of common stock per $1,000 principal of notes (equivalent to approximately $14.35/share). These notes will be convertible at the option of the holders (subject to the satisfaction of specified conditions and during certain periods) and may be settled, at the company's election, in cash, shares of the company's common stock, or a combination thereof.
4. Attributable to three separate loan-agreements entered into by international subsidiaries in Peru and Columbia.
5. Of the 400m of proceeds from the convertible note issuance, Cinemark has earmarked USD 45.8m for a convertible note hedge and warrant transactions with one or more of the initial purchasers of the notes. The remainder of proceeds will be used for general corporate purposes, including paying down the revolver.

Cinemark had USD 571m in cash at 30 June, including USD 98.8m borrowed on a USD 100m revolver due in 2022 and only USD 1.2m available. Revolving lenders have waived covenants through year end, according to the company's SEC filings. A portion of the convertible notes could go toward paying back revolver debt, as reported.

Cinemark also has a USD 700m Libor+ 175bps (no floor) term loan due 2025 quoted in the 86.75/89.5 context, up from 86.5/88 on 17 August, according to Markit.

The convertible note issuance is not the only debt issue that the company has accomplished this year. In late May, Cinemark issued USD 250m 8.75% senior secured notes due 2025. The bonds contain springing maturities to 14 September 2022 if the company's USD 400m 5.125% senior notes due 2022 are not redeemed by 13 September 2022; and a springing maturity to 28 February 2023 if the company does not retire its 4.875% by 27 February 2023.

Its USD 400m 5.125% senior notes due 2022 traded at 92 to yield 9% yesterday, up from 89 to yield 10.4% at the start of last week when the company issued its convertible notes, according to MarketAxess.

Its USD 755m 4.875% senior notes due 2023 traded up to 90 for a yield of 8.7% yesterday from 85 to yield 11.2% on 18 August.

The USD 250m 8.75% senior secured notes due 2025 traded at 106 yesterday to yield 7%, up from 104 on 18 August to yield 7.65% and 101 to yield 8.3% on 22 May, the first institutional trade after the company issued the bonds.

Cinemark officials did not return requests for comment.

by Seth Brumby