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Technicolor dreams of a bright future in digital cinema

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By Richard Verrier

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While much of Hollywood is scaling back, the film processor has invested more than \$200 million in its production facilities. 'We are pushing harder than anybody else in the industry,' the CEO says.

Technicolor has been a fixture since the early days of Hollywood.

The company brought color to the big screen in such classics as "Gone With the Wind" and "The Wizard of Oz." When its pioneering "three-strip" color process fell out of favor, Technicolor reinvented itself as a successful film processor. The company later became a leading duplicator of VHS tapes and DVDs.

Now, after 94 years of serving Hollywood, Technicolor Inc. has planted itself in the heart of Tinseltown, leaving its nondescript headquarters in an industrial neighborhood near Burbank Airport. Its new digs -- a modern, six-story structure at the corner of Sunset Boulevard and Gower Street -- are a symbol of the company's latest transformation.

Technicolor is now refashioning itself to keep pace with the digital revolution that has reshaped the entertainment industry.

It has invested more than \$200 million in digital post production and visual effects facilities, including in Bangalore, India, London and the company's new Hollywood headquarters, as well as in a sound editing facility that is slated to open next year on the Paramount Pictures lot on Melrose Avenue.

"People say Technicolor, it's just fighting to stay in the old business and they will never make it in the digital business," said Frederic Rose, chief executive of Thomson, the French media technology company

that owns Technicolor. "In reality, we are pushing harder than anybody else in the industry to go digital."

The global expansion comes at a time when many other companies that service Hollywood are scaling back in the face of a severe production slowdown. Not that Technicolor has much alternative: The bulk of the company's business derives from replicating DVDs and processing film prints for theaters, both challenged segments. DVD sales are slowing and more movies and TV shows are being shot digitally.

Technicolor is the largest manufacturer of DVDs and remains one of the largest processors of film -- it processed 1.8 billion feet of film during the first half of this year.

But the company also has emerged as a market leader in the processing and distribution of digital cinema. Its new headquarters includes nine digital scanners, which cost more than \$1 million apiece. They are part of a "digital intermediate" process that Technicolor developed several years ago that allows film to be color-corrected and edited on digital equipment as opposed to in a film laboratory using chemicals. The process is less expensive and faster.

As part of a strategy to expand into creative services, Technicolor in March hired Tim Sarnoff away from Imageworks, Sony Pictures' visual effects and computer animation unit, to lead its new Digital Productions division, which creates visual effects for movies, television shows, commercials and video games.

"They could have put their head in the sand and said, 'This is what we do.' But they didn't," said Randi Altman, editor in chief of trade publication Post Magazine. "They've adapted and evolved with the industry."

Technicolor's outlook brightened recently when its parent company reached a deal with creditors to slash 45% of its \$4.1 billion in debt. Thomson, a provider of digital set-top boxes and other telecommunications equipment, amassed the huge debt after a string of costly acquisitions.

As part of a restructuring plan, Thomson is focusing more resources and marketing on Technicolor, which generates \$3 billion in yearly revenue and accounts for about 45% of Thomson's revenue.

Rose, who keeps offices in Hollywood and Paris, wants to position Technicolor as the French company's cornerstone brand. That's a departure from his predecessor Frank Dangeard, who struggled to transform Thomson into a "one-stop shop" of digital equipment and services for movie studios, TV channels and cable and telecommunications companies.

Dangeard resigned last year as Thomson's losses mounted. The board tapped Rose, a former top executive with French telecommunications firm Alcatel-Lucent, to turn things around.

To highlight the Technicolor brand, Rose insisted that all references to "Thomson" be removed from Technicolor signs and employee e-mails. He's also marshaling Thomson's researchers, who helped develop the technology for the MP3 player, to create and patent new technologies for Technicolor's customers, such as finding ways to deliver 3-D entertainment in the home.

Technicolor also is shedding businesses that don't directly involve its key customers -- studios and filmmakers. That includes Premier Retail Networks, a company that manages video networks for

retailers including Wal-Mart; and Screenvision, a joint venture with British broadcaster Carlton Communications that provides advertising for movie theaters. Thomson also plans to unload its Grass Valley unit, which supplies digital cameras, routers and switchers to the broadcast industry.

"The company had stopped focusing on its customer and instead focused on diversions," Rose said. "The new Technicolor is focused exclusively around content creators. What do these people want and what do they need to grow?"

Some aspects of Technicolor's digital strategy haven't worked. The company last year pulled the plug on a planned rollout of digital equipment in theaters, concluding that it wasn't economical and that it veered too far from its core business.

Instead, Technicolor recently devised a system that can show 3-D movies using conventional film projectors, potentially saving exhibitors from spending \$75,000 on a digital projector. The rollout of 3-D screens has been significantly delayed because exhibitors have had difficulty funding the conversion, raising concerns among studio executives who are releasing dozens of 3-D films in the next two years. Technicolor's system will be tested this fall at an undisclosed theater in Los Angeles.

Industry insiders say reaction among studio executives and exhibitors has been mixed. But at least one studio executive who has seen a demonstration of the system is impressed.

"The solution they are working on today could potentially be very helpful to the deployment of the new 3-D platform in theaters across the globe," said DreamWorks Animation SKG chief Jeffrey Katzenberg, who is an outspoken proponent of 3-D.

Technicolor has 13,450 employees, including about 2,000 who work in various offices throughout Los Angeles. Its chief rival is Deluxe Entertainment Services Group Inc., the post production house owned by Ronald Perelman's holding company, MacAndrews & Forbes Holdings Inc. As the world's largest film processing company, Deluxe has faced similar challenges as Technicolor, and also has moved heavily into digital services.

Like other service companies, Technicolor's business was buffeted by last year's labor unrest in Hollywood and the effects of the recession, which slowed film production and further damped DVD sales.

The company cut 1,200 jobs at its North American facilities in 2007, largely because of the slowdown in DVD sales. The mastering and replication of DVDs generates about 40% of the company's revenue. Technicolor saw a 22% drop in DVD replications in the first half of this year.

Yet the company's earnings (before taxes, depreciation and amortization) rose 13% to \$77 million in the first half of 2009, according to a company filing.

One reason has been growth in Technicolor's digital asset management business, which involves encoding movies and TV shows so they can be distributed in various formats, including video on demand and over the Internet.

Another small but growing area for the company is visual effects and computer animation. In late 2004, Technicolor bought the Moving Picture Co., a leading London visual effects house known for its work on

Super Bowl commercials as well as films including the "Harry Potter" movies and "Lara Croft: Tomb Raider."

Moving Picture Co. has offices in London, Vancouver, Canada, and Santa Monica. It also works with an effects and animation house in Bangalore, India, called Paprikaas, which is partly owned by Thomson. Technicolor in 2007 partnered with DreamWorks to build and staff the facility, which has become another production outlet for DreamWorks, animating DVDs, the successful "The Penguins of Madagascar" cable TV series for Nickelodeon and, eventually, feature films.

To be sure, Technicolor is entering an arena dominated by larger, more established players such as Sony Pictures Imageworks and Industrial Light & Magic. A number of visual effects firms have struggled with the high cost of producing effects and overseas competition, and some, notably the Orphanage in San Francisco, have gone out of business.

Sarnoff, who is working to integrate the various facilities, says Technicolor can compete by offering high-quality effects at a lower cost than rivals.

"Technicolor has a distinct advantage in that it is truly a global company," he said. "It has facilities in places where they already have tax incentives and strong talent pools."

richard.verrier@latimes.com

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