

5. Financial results

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Introduction

5.1. In this chapter we first set out our estimates of the `shares of the cake', ie the division of (a) box office takings and (b) total revenues from the exhibition of films in UK cinemas between exhibitors' costs and profits, distributors' costs and profits, and payments for distribution rights. We then look at the results of a selection of individual films to see how the rentals received by the distributors and the contribution after direct costs vary with box office takings.

5.2. We then consider the financial performance of the main distributors. We aggregate financial information from the five leading distributors, Buena Vista, Columbia, Fox, UIP and Warner Distributors, which are all vertically linked to one or more Hollywood studios, to show their overall results from UK film distribution. Table 4.2 shows that these five distributors accounted for some 76.6 per cent of rental receipts from UK film distribution in the calendar years 1990 to 1993 inclusive. We also consider separately the results of the two largest independent distributors, Guild and RFD, which accounted for a further 8.3 per cent and 4.7 per cent of rental receipts respectively in that period.

5.3. Finally, we consider the financial performance of the five leading exhibitors: MGM Cinemas, Natl Amusements, Odeon, UCI and Warner Theatres. Tables 4.7 and 4.8 show that these accounted for 78.6 per cent of cinema box office takings and 77.6 per cent of rental payments to distributors in the calendar years 1990 to 1993 inclusive. In the case of Natl Amusements and UCI we have taken into account relevant parts of the results of their overseas affiliated companies which own some of the UK cinema sites for which Natl Amusements and UCI are the operators. We aggregate the results of these five exhibitors to give their overall profitability from film exhibition in UK cinemas.

‘Shares of the cake’

5.4. We have examined the ‘shares of the cake’ in two ways. First, we have looked at the division of box office takings alone, treating other income, such as sales of refreshments (known in the trade as ‘concession income’) and screen advertising revenue as deductions from exhibitors’ costs. Table 5.1 sets out, in percentage terms, our estimates of how box office takings of films distributed by the five leading distributors in their accounting periods 1989 to 1993 were divided between exhibitors’ costs and profits, distributors’ costs and profits and distributors’ payments for distribution rights. Secondly, we have looked at the division of total revenues, not only box office takings, but also concession income, screen advertising and other income. Table 5.2 therefore sets out, as an alternative, the division of these total revenues. For this exercise we have only used information from the five leading distributors and the five leading exhibitors but, as already pointed out, they accounted for 76.6 per cent of rentals received from exhibitors and 78.6 per cent of box office takings respectively.

5.5. Table 5.1 shows that over the period, 45.0 per cent of box office takings went in meeting exhibitors’ costs (after deducting concession and other income), 18.8 per cent represented exhibitors’ profits before interest and taxation and 23.3 per cent went in meeting distributors’ costs. 12.4 per cent was payable, mainly overseas, for the cost of distribution rights. Taken overall, the distributors were left with only a small profit from theatrical exhibition after making these payments, although this takes no account of the streams of income and profit from other forms of exhibition which may be affected by success in the cinema.

TABLE 5.1 Percentage division of box office takings

	<i>Periods*</i>					<i>per cent</i>
	<i>1989</i>	<i>1990</i>	<i>1991</i>	<i>1992</i>	<i>1993</i>	<i>1989 to 1993</i>
Exhibitors' costs excluding rental payments						
less concession and other income	46.3	46.5	44.7	47.4	40.6	45.0
Exhibitors' profits before interest and tax	12.8	16.7	20.8	18.7	23.4	18.8
Distributors' costs less sundry income	21.6	21.3	29.7	23.8	21.6	23.3
Cost of distribution rights	18.6	15.2	4.5	10.1	13.4	12.4
Distributors' profits after cost of distribution rights	<u>0.7</u>	<u>0.3</u>	<u>0.3</u>	<u>(0.0)</u>	<u>1.0</u>	<u>0.5</u>
Box office takings	100.0	100.0	100.0	100.0	100.0	100.0

Source: MMC using data from the five leading distributors and the five leading exhibitors.

*Company accounting periods ending in the year shown or early in the following year.

5.6. Table 5.2 shows that over the period total revenues were made up of about 72.6 per cent box office takings, 21.5 per cent concession income and 5.9 per cent other income (mainly screen advertising). The table reveals the significance of concession income to the exhibitors. Of these total revenues, some 60.0 per cent went in meeting exhibitors’ costs (including the purchase of goods for resale as refreshments etc), 13.7 per cent represented exhibitors’ profits before interest and taxation, 16.9 per cent went in meeting distributors’ costs and 9.0 per cent was payable, mainly overseas, in payment for distribution rights. The distributors’ profit after the cost of distribution rights, but before interest and tax, was 0.4 per cent.

TABLE 5.2 Percentage division of box office takings and other income

	<i>Periods*</i>					<i>per cent</i>
	<i>1989</i>	<i>1990</i>	<i>1991</i>	<i>1992</i>	<i>1993</i>	<i>1989 to 1993</i>
	Box office takings	74.3	72.7	72.1	72.0	72.3
Concession income	19.1	21.1	21.9	22.2	22.6	21.5
Other income	<u>6.6</u>	<u>6.2</u>	<u>6.0</u>	<u>5.8</u>	<u>5.1</u>	<u>5.9</u>
Total revenue	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Exhibitors' costs excluding rental payments	60.1	61.1	60.1	62.2	57.1	60.0
Exhibitors' profits before interest and tax	9.5	12.1	15.0	13.4	16.9	13.7
Distributors' costs less sundry income	16.1	15.5	21.4	17.1	15.6	16.9
Cost of distribution rights	13.7	11.1	3.3	7.3	9.7	9.0
Distributors' profits after cost of distribution rights	<u>0.6</u>	<u>0.2</u>	<u>0.2</u>	<u>(0.0)</u>	<u>0.7</u>	<u>0.4</u>
Total revenue	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

Source: MMC using data from the five leading distributors and the five leading exhibitors.

*Company accounting periods ending in the year shown or early in the following year.

5.7. Tables 5.1 and 5.2 show that exhibitors' profits (before interest and taxation) have risen as a percentage of both box office receipts and total revenues during the five-year period. Distributors' profits before the cost of distribution rights fell sharply from 1989 to 1991, but they recovered in the two most recent years as both distributors' and exhibitors' costs fell in relation to total revenues. The distributors took some of the strain of the recession by incurring costs in 1991 and 1992 that were higher in relation to rentals than in 1989, 1990 and 1993, and as a result the producers suffered a sharp fall in amounts receivable for distribution rights, not only in terms of percentages of box office takings and total cinema revenues, but also in absolute terms (Table 5.4 shows the fall in the cost of distribution rights in 1991 and 1992). The share of box office takings is shown in Figure 5.1, in which the small profit or loss of the distributors has been combined with payments for distribution rights to give the total share accruing to the Hollywood parent companies.

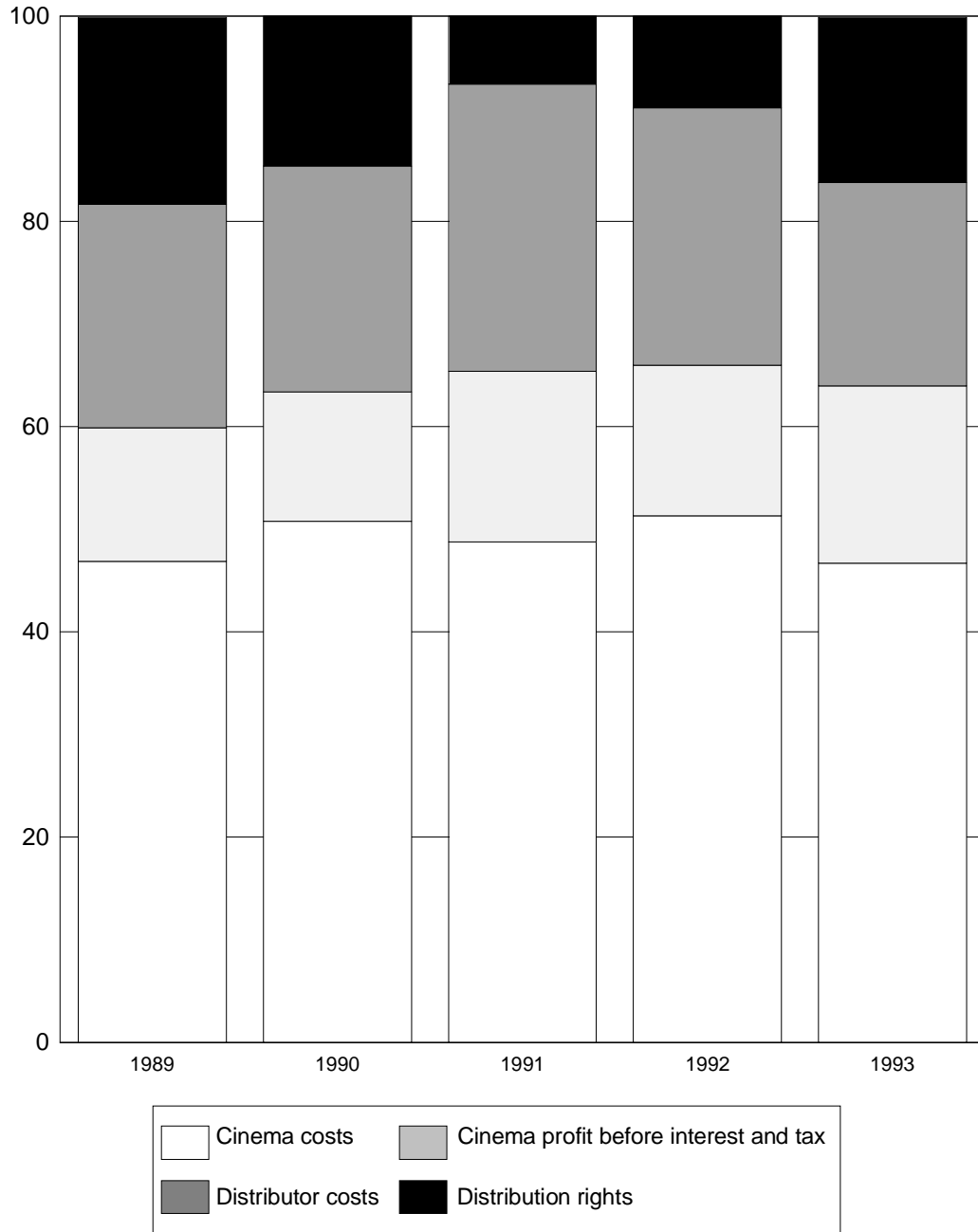
Results of individual films

5.8. It is possible to calculate from Tables 5.1 and 5.2 that the rentals paid to distributors amounted to 36.2 per cent of box office takings and 26.3 per cent of exhibitors' turnover for the five years 1989 to 1993; the amount payable to the distributors' parent studios for distribution rights was 12.4 per cent of box office takings and 9.0 per cent of exhibitors' turnover. These percentages were averages for the leading exhibitors and distributors, but were not necessarily representative of individual films.

5.9. We received information from some of the distributors concerning the profitability of the films selected by them for the case studies discussed in Appendix 4.10. This is not a representative sample of films, being taken from the top five, bottom five and a typical five for each distributor. Also the results of individual films may be spread over more than one financial year, so that they cannot be agreed to audited accounts. However, we believe the results of these films give a broad indication of how profitability varies with success at the box office. In Table 5.3 we set out the results of 38 films grouped according to box office takings. For each group, the table gives the average box office takings, rentals, distributor's direct costs and contribution. These same amounts are also shown as a percentage of box office takings.

FIGURE 5.1

Shares of the cake, based on box office takings



Source: MMC using data from the five leading distributors and the five leading exhibitors.

TABLE 5.3 Average box office takings, rentals, direct costs and contribution of selected films

£'000

Range of box office takings	Number of films	Box office takings	Rental receipts	Prints and trailers	Advertising and publicity	Other costs	Contribution*
0 - 1,000	6	641	177	92	342	2	(259)
1,000 - 2,500	11	1,713	508	149	433	10	(84)
2,500 - 5,000	7	3,484	1,158	185	549	14	410
5,000 - 10,000	4	6,491	2,473	166	799	67	1,441
10,000 - 20,000	10	13,157	5,803	298	1,034	12	4,459
<i>Percentages of box office takings</i>							
0 - 1,000	6	100.0	27.6	14.3	53.3	0.4	(40.4)
1,000 - 2,500	11	100.0	29.7	8.7	25.3	0.6	(4.9)
2,500 - 5,000	7	100.0	33.2	5.3	15.7	0.4	11.8
5,000 - 10,000	4	100.0	38.1	2.6	12.3	1.0	22.2
10,000 - 20,000	10	100.0	44.1	2.3	7.8	0.1	33.9

Source: MMC using distributors' data.

*Contribution before distributors' indirect costs.

5.10. Table 5.3 shows the effects on the profitability of individual films of the system of nuts and sliding scales (described in paragraphs 4.136 to 4.139) and the relatively small variation in the distributor's direct costs between successful and unsuccessful films. Films with box office takings below £2.5 million received little more than the minimum rental of 25 per cent. Such films made up the majority; we have been told that in both 1992 and 1993 only 39 films had box office takings above £2.5 million. This relatively small number of films would have been generally profitable, increasingly so as box office takings increased. The much greater number of films with box office takings below £2.5 million would, in most cases, have failed to cover the distributor's costs so that there would be no return to the producer from them. *Jurassic Park*, the most successful film during the five years, is not included in the above table. Its rental receipts and contribution as percentages of box office takings were above the highest levels in the table. The presence or absence of successful films in any year is the principal determinant of a distributor's profitability.

Financial results: distributors

5.11. We received financial information from the five leading distributors and from the two largest independents, Guild and RFD, and the tables in Appendix 5.1 are based on the statements submitted by them. Although there may be minor inconsistencies in the way in which these seven distributors have classified some items of income, cost and capital employed, we believe these are unlikely to have had a material effect on the results shown. Costs and capital employed that are not wholly attributable to UK film distribution have generally been apportioned by the distributors on a turnover basis. Where a distributor's accounting period does not coincide with the calendar year, figures for the period ending during the year or, in the case of Columbia, early in the following year have been used. All the information on the distributors in this chapter is based on their financial years, sometimes causing small differences from the information in other chapters where a calendar year basis has been used.

Distribution rights

5.12. The five leading distributors are all owned by one or more Hollywood studios which are also their principal suppliers. They generally operate under some form of licensing or franchising agreement, whereby substantially all or most of their rentals, after deduction of operating expenses, are payable to their Hollywood suppliers in consideration of the distribution rights acquired. These arrangements are more fully described in Appendix 5.1. They sometimes acquire distribution rights to films from independent producers

on an arm's length basis, but for most of their films they are performing a sales and marketing function for their parent studios. Their business does not require much working capital or fixed assets.

5.13. Guild, RFD and the smaller independent distributors, on the other hand, are usually not connected with the companies from which they obtain distribution rights. They negotiate the acquisition of these rights on an arm's length basis. This frequently involves some participation in the financing of the production of the films in question and assuming some of the associated risks.

The five leading distributors

5.14. Table 5.4 sets out the five leading distributors' aggregated financial results from UK film distribution for their last five accounting periods. Appendix 5.1 contains similar information for each of the five leading distributors.

TABLE 5.4 **The five leading distributors: aggregated results from UK film distribution**

	<i>Periods*</i>					<i>£'000</i>
	<i>1989</i>	<i>1990</i>	<i>1991</i>	<i>1992</i>	<i>1993</i>	<i>Total</i>
<i>Turnover</i>						
Gross rentals	61,569	76,747	53,780	69,325	85,204	346,625
Other revenue	<u>876</u>	<u>1,560</u>	<u>924</u>	<u>747</u>	<u>2,089</u>	<u>6,196</u>
Total	<u>62,445</u>	<u>78,307</u>	<u>54,704</u>	<u>70,072</u>	<u>87,293</u>	<u>352,821</u>
<i>Direct costs</i>						
Prints, trailers etc	6,428	8,573	8,884	8,702	10,283	42,870
Advertising and publicity	21,527	30,640	32,760	35,207	36,065	156,199
Other direct costs	<u>445</u>	<u>515</u>	<u>511</u>	<u>535</u>	<u>824</u>	<u>2,830</u>
Total	<u>28,400</u>	<u>39,728</u>	<u>42,155</u>	<u>44,444</u>	<u>47,172</u>	<u>201,899</u>
Contribution	34,045	38,579	12,549	25,628	40,121	150,922
<i>Indirect costs</i>						
Staff costs	2,439	3,052	2,588	2,559	3,012	13,650
Accommodation	618	1,130	792	941	781	4,262
General administration	2,089	2,208	1,790	1,531	2,241	9,859
Other	<u>(121)</u>	<u>(85)</u>	<u>(182)</u>	<u>(82)</u>	<u>0</u>	<u>(470)</u>
Total	<u>5,025</u>	<u>6,305</u>	<u>4,988</u>	<u>4,949</u>	<u>6,034</u>	<u>27,301</u>
Operating profit before cost of distribution rights	29,020	32,274	7,561	20,679	34,087	123,621
Cost of distribution rights	<u>27,817</u>	<u>31,712</u>	<u>7,081</u>	<u>20,691</u>	<u>31,634</u>	<u>118,935</u>
Operating profit after payment for distribution rights	<u>1,203</u>	<u>562</u>	<u>480</u>	<u>(12)</u>	<u>2,453</u>	<u>4,686</u>
<i>Tangible capital employed at period end</i>						
Tangible fixed assets	3,396	3,651	3,102	3,150	2,859	
Fixed asset investments	11	11	11	11	11	
Net current assets (excluding net borrowings)	<u>6,026</u>	<u>2,546</u>	<u>9,172</u>	<u>7,081</u>	<u>11,641</u>	
Capital employed	<u>9,433</u>	<u>6,208</u>	<u>12,285</u>	<u>10,242</u>	<u>14,511</u>	

Source: MMC using the five leading distributors' data.

*Accounting periods ending in the year shown or early in the following year. Columbia's 1992 accounting period covered 13 months and UIP's 1990 accounting period covered 18 months.

5.15. Table 5.5 gives a number of cost and profitability ratios for these distributors, based on the results set out in Table 5.4. We have calculated ROT both before and after the cost of distribution rights. The latter is of little use in measuring financial performance because, as noted in paragraph 5.12, payments to affiliated studios for distribution rights leave only a small profit or loss in the UK. Although in many past monopoly inquiries we have found ROCE to be a useful profitability indicator, we do not find it to be of much assistance in measuring the performance of the leading distributors. They are not engaged in manufacturing and their activities are generally not capital-intensive. With their very small capital employed, ROCE

calculated before the cost of distribution rights would usually exceed 100 per cent, while ROCE after these costs would often be small or negative. We believe that for our purposes the best measure of the overall performance of the vertically integrated distributors is ROT before the cost of distribution rights. This is not a measure of overall profit, since it takes no account of the costs incurred by affiliated companies, notably on film production.

TABLE 5.5 **The five leading distributors: aggregated operating ratios from UK film distribution**

	<i>Periods*</i>					<i>per cent</i>
	<i>1989</i>	<i>1990</i>	<i>1991</i>	<i>1992</i>	<i>1993</i>	<i>Total</i>
<i>Percentages of turnover</i>						
Gross rentals	98.6	98.0	98.3	98.9	97.6	98.2
Other revenue	1.4	2.0	1.7	1.1	2.4	1.8
Prints, trailers etc	10.3	10.9	16.2	12.4	11.8	12.1
Advertising and publicity	34.5	39.1	59.9	50.2	41.3	44.3
Other direct costs	<u>0.7</u>	<u>0.7</u>	<u>1.0</u>	<u>0.8</u>	<u>0.9</u>	<u>0.8</u>
Direct costs	45.5	50.7	77.1	63.4	54.0	57.2
Contribution	54.5	49.3	22.9	36.6	46.0	42.8
Indirect costs	8.0	8.1	9.1	7.1	6.9	7.8
Operating profit (ROT) before distribution rights	46.5	41.2	13.8	29.5	39.1	35.0
Cost of distribution rights	44.6	40.5	12.9	29.5	36.3	33.7
Operating profit (ROT) after distribution rights	1.9	0.7	0.9	(0.0)	2.8	1.3

Source: MMC using the five leading distributors' data.

*Accounting periods ending in the year shown or early in the following year. Columbia's 1992 accounting period covered 13 months and UIP's 1990 accounting period covered 18 months.

5.16. Table 7 in Appendix 5.1 gives the rentals, other income and total turnover from UK film distribution for each of the five leading distributors in their last five accounting periods. Table 8 shows for each of these distributors a number of cost and profitability items expressed as percentages of turnover.

Guild

5.17. Although Guild was acquired by Chargeurs SA in 1992, its new parent company has not so far been an important source of films and Guild has retained the character of an independent distributor. Guild provided us with the same information as the leading distributors, but because of its different situation as an independent we have not aggregated its results with theirs in Tables 5.4 and 5.5. However, we have drawn on its information at certain points for purposes of comparison. The results of Guild are set out in Table 9 of Appendix 5.1. [

Details omitted. See note on page iv.

]

RFD

5.18. RFD is substantially engaged in a number of activities other than film distribution in the UK. It distributes films in the UK for exhibition on television and for supply as video cassettes. It also distributes films overseas. It told us that it usually bought distribution rights as a single package and could not identify how much of its payments for distribution rights related to theatrical distribution in the UK and how much to its other activities. RFD was therefore unable to provide us with financial information in the form that we had requested. It provided us instead with analyses of its trading profits for the last five years, together with allocations of its indirect costs to UK theatrical distribution. We have used this information in Table 10 of Appendix 5.1.

Commentary on financial results

5.19. The aggregated annual film rentals of the five leading distributors increased during the period from £61.6 million to £85.2 million (Table 5.4). The erratic trend between 1989 and 1991 was partly accounted for by a change in UIP's accounting date, as a result of which its 1990 accounting period covered 18 months. In Table 5.6 we have restated the aggregated rentals of the leading distributors (both including and excluding Guild and RFD) to adjust for the effects of UIP's 18-month accounting period in 1990 and Columbia's 13-month accounting period in 1992. We have also recalculated these rentals at 1993 prices to exclude the effects of inflation.

TABLE 5.6 Restatement of aggregate gross rentals to show trends on a yearly basis

	Periods					£'000
	1989	1990	1991	1992	1993	
<i>The five leading distributors, Guild and RFD</i>						
At nominal prices	65,859	70,863	76,518	79,180	93,117	
At calendar year 1993 prices	80,297	80,204	80,996	80,605	93,231	
<i>The five leading distributors only</i>						
At nominal prices	62,457	62,811	53,780	67,731	85,204	
At calendar year 1993 prices	76,101	71,158	56,966	68,967	85,314	
<i>Annual increase based on 1993 calendar year prices</i>						
The leading distributors, Guild and RFD		(0.1)	1.0	(0.5)	15.7	per cent
The five leading distributors only		(6.5)	(19.9)	21.1	23.7	

Source: MMC using data from the five leading distributors, Guild and RFD.

5.20. Table 5.6 shows that the 1993 rentals of the five leading distributors were 36.4 per cent higher than their 1989 rentals, but only 12.1 per cent higher when adjusted for inflation. When the rentals of Guild and RFD are included rental growth over these four years was 41.4 per cent, but only 16.1 per cent when adjusted for inflation. Virtually all the growth took place in 1993, helped by the extraordinary success of UIP's *Jurassic Park*. The different year-on-year growth rates when Guild and RFD are included is mostly caused by their exceptional performance in 1991, when the most successful films included *Terminator II* (Guild), *Silence of the Lambs* (RFD) and *Dances with Wolves* (Guild).

5.21. Table 7 of Appendix 5.1 shows that UIP was the largest distributor in terms of film rentals received, with a total of £131.3 million in five and a half years, an average of £23.9 million a year. Its rentals were unusually high in 1993, due to its UK release of *Jurassic Park*. Warner Distributors was next, with rentals of £117.8 million over five years, an average of £23.6 million a year. The loss of the distribution of Disney films to Buena Vista in 1993 was largely offset by the success of films from the Time Warner group in that year. Columbia was third largest, with an average of £10.9 million a year, followed by Fox whose average was £6.5 million a year (the same as Guild).

5.22. Table 5.5 shows that before distribution rights, average ROT for the five leading distributors reached 46.5 per cent in 1989, the highest level in the last five years. The lowest level was 13.8 per cent in 1991 when none of the five distributors had especially successful films. Table 8 of Appendix 5.1 shows that ROT before the cost of distribution rights tended to reflect size. UIP with [*] per cent was highest over the period. Warner Distributors was next with [*] per cent, followed by Columbia and Fox with [*] and [*] per cent respectively. Guild averaged [*] per cent but varied between [*] per cent in 1991 and a negative [*] per cent in 1993 (disregarding the heavy percentage loss in 1989 when its film distribution activities were negligible). This may have reflected its lack of an ownership link with a Hollywood studio and the consequent difficulties it faces in having to compete for successful films for distribution. Buena Vista made [*] per cent in 1993, its first year of operation.

*Figures omitted. See note on page iv.

5.23. The effect of the arrangements made by the leading distributors to acquire distribution rights from their affiliated studios can be seen in Table 5.5. While the aggregate ROT over the period was 35.0 per cent before the cost of distribution rights, it was reduced to a negligible 1.3 per cent after the cost of distribution rights had been deducted.

5.24. Table 5.4 shows that expenditure by the five leading distributors on direct costs increased throughout the period from £28.4 million in 1989 to £47.2 million in 1993. In Table 5.5 it can be seen that these direct costs absorbed 57.2 per cent of turnover over the period and a disproportionately large share (77.1 per cent) in 1991 when rental income was relatively low. Advertising and publicity, the largest element of direct costs, increased from 34.5 per cent of turnover in 1989 to 59.9 per cent in 1991 before falling back to 41.3 per cent in 1993, giving an average of 44.3 per cent over the period. As regards individual distributors, Table 8 of Appendix 5.1 shows that UIP spent least on average at [*] per cent of turnover over the five years, partly because of its high revenue from *Jurassic Park*. Columbia, Fox and Warner Distributors all averaged [*] to [*] per cent. Guild tended to spend most heavily on advertising and publicity in relation to rental receipts, with an overall average of [*] per cent of turnover, possibly reflecting its position as an independent. The five leading distributors spent an average of around 12.1 per cent of turnover on prints, trailers etc, varying from [*] per cent (UIP) to [*] per cent (Columbia), except for Buena Vista, which spent [*] per cent in 1993, its first year of operation.

5.25. RFD's results are not directly comparable with those of the other distributors because of the different form in which they are presented. However, its average UK theatrical commission income (Table 10 of Appendix 5.1) was [*] per cent of its turnover from UK theatrical distribution, after the cost of acquiring distribution rights. This was, however, before indirect costs of [*] per cent and its operating profit of [*] per cent after the cost of distribution rights is close to the [*] per cent of the five leading distributors. RFD's overall operating profit averaged [*] per cent of turnover over the five-year period, but this is not comparable with the results of the other distributors because of the inclusion of RFD's other activities.

Financial results: exhibitors

5.26. Film exhibition is a capital-intensive activity and the balance sheets of the exhibitors are dominated by the cost of their investment in cinemas. ROCE is therefore a better measure of the profitability of the exhibitors than ROT. In line with their statutory and management accounts, some exhibitors included their cinemas at valuation rather than historical cost in the information provided to us, which has the effect in most instances of substantially reducing ROCE. We therefore asked them to restate their assets at historical cost and to recalculate depreciation on the basis of this cost so that ROCE would reflect the actual return on the amounts invested by them in their exhibition business. We also asked the exhibitors to exclude from capital employed any assets which did not make a contribution to trading profits such as construction in progress. We asked one of the exhibitors, who entered into a sale and leaseback transaction for some of its cinemas but reacquired them three years later, to restate its results to reflect the fact that it continued to enjoy the economic benefits of these assets.

5.27. The statements submitted to us by the five leading exhibitors have been summarized in Tables 1 to 7 of Appendix 5.2. Costs and capital employed that are not wholly attributable to the exhibition of films in UK cinemas have normally been apportioned by the companies on a turnover basis.

5.28. The financial information for MGM Cinemas includes its operations in the Republic of Ireland, which account for 1.9 per cent of turnover. Because of its immateriality, we did not ask MGM Cinemas to undertake a special exercise to eliminate its Irish operation from the results submitted to us. The figures for UCI consolidate 100 per cent of the cinema operations of Milton Keynes Entertainment Company Limited (MKEC) for the five years 1989 to 1993, although MKEC only became a wholly-owned subsidiary in 1993. UCI's results also include those of the two West End cinemas, the Empire and the Plaza, which it operates on behalf of its affiliate, CIC. In Appendix 5.2 the financial results of UCI are set out in Table 4 and those of CIC in Table 5, but in the rest of the appendix and in this chapter their combined results have been included as those of UCI. Natl Amusements and UCI operate cinemas which are owned by overseas affiliated companies, and we have taken into account the relevant parts of the results of these affiliated companies. In

*Figures omitted. See note on page iv.

Appendix 5.2 the results of Warner Bros Theatres Limited, which operates the Warner West End cinema, are set out in Table 6 and those of Warner Bros Theatres (UK) Limited, which operates a chain of multiplexes, in Table 7. Thereafter in Appendix 5.2 and in this chapter the combined results of these companies have been included under Warner Theatres.

5.29. Odeon's financial year ends on 31 October and that of Warner Theatres on 30 November, while the financial years of the other three leading exhibitors coincide with the calendar year. All the information on the leading exhibitors in this chapter is based on their financial years, sometimes causing small differences from the information in other chapters where a calendar year basis has been used.

5.30. In paragraph 5.26 we have explained that the results of the exhibitors have been restated when necessary in order to eliminate revaluations of fixed assets. With the results of all the exhibitors on a historical cost basis, those which operate old cinemas with low historical costs and a high level of accumulated depreciation have very high returns. Tables 5 and 6 of Appendix 5.2 show the unusually high ROCE of CIC and Warner Bros Theatres Limited (included in the results of UCI and Warner Theatres respectively). This restatement is also significant in the case of Odeon, which has owned most of its cinemas since the 1930s.

Aggregated results

5.31. Table 5.7 has been compiled from the information on individual exhibitors set out in Tables 1 to 7 of Appendix 5.2. It gives the five leading exhibitors' aggregated financial results from the exhibition of films in UK cinemas for the five years to 1993. Although there may be minor inconsistencies in the way in which the exhibitors have classified some items of income, cost and capital employed, we believe that these are unlikely to have had a material effect on the aggregated results in Table 5.7.

TABLE 5.7 The five leading exhibitors: aggregated results on exhibition in UK cinemas

	Financial years ending in						£'000
	1988	1989	1990	1991	1992	1993	Total
<i>Turnover excl VAT</i>							
Box office takings	-	143,750	169,539	194,492	203,336	234,636	945,753
Screen advertising	-	8,222	10,983	11,950	12,221	12,242	55,618
Concessions	-	37,003	49,172	58,951	62,603	73,323	281,052
Other revenue	-	4,400	3,435	4,305	4,346	4,500	20,986
Total	-	<u>193,375</u>	<u>233,129</u>	<u>269,698</u>	<u>282,506</u>	<u>324,701</u>	<u>1,303,409</u>
<i>Costs</i>							
Film rental payments	-	58,766	62,333	67,146	68,989	84,381	341,615
Concession cost of sales	-	17,135	19,898	21,682	22,069	23,986	104,770
Advertising and publicity	-	5,479	7,143	8,319	9,550	9,835	40,326
Staff costs	-	41,007	50,200	56,727	61,677	65,448	275,059
Depreciation	-	10,957	19,320	22,154	23,884	25,049	101,364
Other operating costs	-	41,694	45,942	53,232	58,379	61,162	260,409
Total	-	<u>175,038</u>	<u>204,836</u>	<u>229,260</u>	<u>244,548</u>	<u>269,861</u>	<u>1,123,543</u>
Operating profit	-	<u>18,337</u>	<u>28,293</u>	<u>40,438</u>	<u>37,958</u>	<u>54,840</u>	<u>179,866</u>
<i>Tangible capital employed at year end</i>							
Tangible fixed assets	179,689	290,452	321,230	360,670	371,915	414,746	
Fixed asset investments	4,160	5,781	3,857	4,276	3,716	61	
Net current assets (excluding net borrowings)	(21,295)	(26,861)	(33,646)	(33,168)	(31,555)	(31,419)	
Capital employed	<u>162,554</u>	<u>269,372</u>	<u>291,441</u>	<u>331,778</u>	<u>344,076</u>	<u>383,388</u>	
Average capital employed*		215,965	280,408	311,686	337,725	358,678	295,057

Source: MMC using the five leading exhibitors' data.

*The calculation of average capital employed of Warner Theatres has been adjusted for the closure of the company's West End cinema between 12 September 1991 and 24 September 1993 for conversion into a nine-screen cinema.

5.32. Table 5.7 shows that in the aggregate the five leading exhibitors' box office takings grew from £143.8 million in 1989 to £234.6 million in 1993, in part reflecting their investment in new cinemas and screens. Table 8 of Appendix 5.2 sets out the components of turnover of the five leading exhibitors in their last five accounting years. It can be seen that MGM Cinemas was the largest exhibitor, with total box office takings of £341.9 million over the five-year period, an average of £68.4 million a year. Odeon was next largest, with £251.6 million over the five years and an annual average of £50.3 million. It was followed by UCI, with £226.6 million over the five years and an annual average of £45.3 million. UCI, however, was growing fast and if the box office takings of its affiliate, CIC, are included it had overtaken Odeon in 1992. Natl Amusements, at £77.0 million, and Warner Theatres, at £48.7 million, were considerably smaller than the other three leading exhibitors but had the highest growth rates in box office takings in 1993.

5.33. Table 5.8 gives a number of significant cost and profitability ratios, including ROT and ROCE, for these five exhibitors, calculated from the information in Table 5.7.

TABLE 5.8 The five leading exhibitors: aggregated results on exhibition in UK cinemas

	Financial years ending in					per cent
	1989	1990	1991	1992	1993	Total
<i>Percentages of turnover</i>						
Box office takings	74.3	72.7	72.1	72.0	72.3	72.6
Screen advertising revenue	4.3	4.7	4.4	4.3	3.8	4.3
Concession income	19.1	21.1	21.9	22.2	22.6	21.6
Other revenue	2.3	1.5	1.6	1.5	1.3	1.5
Costs	90.5	87.9	85.0	86.6	83.1	86.2
Operating profit (ROT)	9.5	12.1	15.0	13.4	16.9	13.8
<i>Other ratios</i>						
Film rental payments: box office takings	40.9	36.8	34.5	33.9	36.0	36.1
Operating profit: average capital employed (ROCE)	8.5	10.1	13.0	11.2	15.3	12.2

Source: MMC using the five leading exhibitors' data.

5.34. Table 5.8 shows that concession income as a percentage of turnover averaged 21.6 per cent over the five-year period, and rose from 19.1 per cent in 1989 to 22.6 per cent in 1993. Table 8 of Appendix 5.2 indicates that this is partly because of the increasing market share of the multiplex chains which derive a higher proportion of their turnover from concession income than the two main circuits; but the importance of concession income for Odeon and MGM Cinemas also grew over the period. To demonstrate the importance of concessions to the exhibitors, Table 5.9 shows the gross profit from this source and compares this profit with the exhibitors' total operating profit. For the five years 1989 to 1993 the gross profit from concessions of £176.3 million was close to the total operating profit of £179.9 million. If no allowance were made for the share of indirect costs attributable to concessions, film exhibition and the other ancillary activities would have only recorded a very small profit.

TABLE 5.9 The five leading exhibitors: contribution of concessions

	Financial years ending in					£'000
	1989	1990	1991	1992	1993	Total
Concession income	37,003	49,172	58,951	62,603	73,323	281,052
Concession cost of sales	<u>17,135</u>	<u>19,898</u>	<u>21,682</u>	<u>22,069</u>	<u>23,986</u>	<u>104,770</u>
Concession gross profit	<u>19,868</u>	<u>29,274</u>	<u>37,269</u>	<u>40,534</u>	<u>49,337</u>	<u>176,282</u>
Total operating profit	<u>18,337</u>	<u>28,293</u>	<u>40,438</u>	<u>37,958</u>	<u>58,840</u>	<u>179,866</u>
<i>per cent</i>						
Concession gross profit:						
total operating profit	108.3	103.5	92.2	106.8	90.0	98.0
concession income	53.7	59.5	63.2	64.7	67.3	62.7

Source: MMC using the five leading exhibitors' data.

5.35. According to Table 5.8, the aggregate profitability of the five leading exhibitors, in terms of both ROT and ROCE, improved year on year from 1989 to 1993, except for a slight reversal in 1992. Table 9 of Appendix 5.2 shows that each exhibitor increased its ROCE over these five years except for Odeon-its ROT hardly varied, but its ROCE was more than halved. Odeon told us that if its fixed assets were stated at current market value, instead of historical cost, its ROCE would have shown little movement since 1990.

5.36. Rental payments as a percentage of box office takings are seen in Table 5.8 to have fallen from their highest level for the five-year period of 40.9 per cent in 1989 to a low point of 33.9 per cent in 1992, before recovering to 36.0 per cent in 1993. However, if the box office takings and rental payments of *Jurassic Park* were eliminated from the 1993 results, rental payments would have continued to decline as a percentage of box office takings.

Profitability of the exhibitors

5.37. Three ratios, operating profit per admission, admissions per seat and capital employed per seat, can be combined to give ROCE.¹ In the section following we look at each of these ratios and their components for the leading exhibitors and use them to explain differences in financial performance.

Operating profit per admission

5.38. Table 10 of Appendix 5.2 sets out box office receipts, concession gross profit and the principal variable costs per admission for each of the leading exhibitors. This table is summarized in Table 5.10.

TABLE 5.10 **The five leading exhibitors: average revenues and costs per admission, 1989 to 1993**

	<i>Financial years ending</i>					£
	1989	1990	1991	1992	1993	
Box office receipts	2.16	2.39	2.62	2.70	2.74	
Concession gross profit	0.30	0.41	0.50	0.54	0.58	
Film rental	(0.88)	(0.88)	(0.90)	(0.92)	(0.98)	
Other costs less other revenues	<u>(1.30)</u>	<u>(1.52)</u>	<u>(1.68)</u>	<u>(1.82)</u>	<u>(1.70)</u>	
Operating profit	<u>0.28</u>	<u>0.40</u>	<u>0.54</u>	<u>0.50</u>	<u>0.64</u>	
						'000
Admissions	66,413	70,820	74,215	75,252	85,666	

Source: MMC using the five leading exhibitors' data.

5.39. The leading exhibitors benefited not only from an increase in admissions of 29.0 per cent from 1989 to 1993, but also an increase of more than 125 per cent in profit per admission before interest and tax. Table 10 of Appendix 5.2 gives the performance of the individual exhibitors. In 1989 Warner Theatres only had a single West End cinema, with higher costs and box office receipts per admission than the other exhibitors (although with its growing chain of multiplex cinemas its results have come to resemble more closely those of its competitors). Apart from Warner Theatres, Odeon had the highest box office prices and until 1993 it generated the highest rentals per admission. Natl Amusements, with low operating costs, has emerged as the most profitable exhibitor in terms of operating profit per admission.

5.40. Fixed costs are more usefully considered in terms of cost per seat rather than cost per admission. Table 11 of Appendix 5.2, which sets out the principal fixed costs of each of the leading exhibitors analysed in this way, is summarized in Table 5.11.

¹ROCE = $\frac{\text{Operating profit}}{\text{Admissions}} \times \frac{\text{Admissions}}{\text{Ave number of seats}} \times \frac{\text{Ave number of seats}}{\text{Ave capital employed}}$

TABLE 5.11 The five leading exhibitors: average fixed costs per seat, 1989 to 1993

	Financial years ending in					£
	1989	1990	1991	1992	1993	
Staff costs	159.20	172.47	185.16	192.26	199.05	
Advertising and publicity	21.27	24.54	27.15	29.77	29.91	
Depreciation	42.54	66.38	72.31	74.45	76.18	
Other operating costs	<u>161.87</u>	<u>157.83</u>	<u>173.76</u>	<u>181.97</u>	<u>186.03</u>	
	<u>384.88</u>	<u>421.22</u>	<u>458.38</u>	<u>478.45</u>	<u>491.17</u>	
						Units
Average number of seats	257,576	291,070	306,364	320,806	328,797	

Source: MMC using the five leading exhibitors' data.

5.41. Fixed costs per seat increased by 27.6 per cent from 1989 to 1993. By far the largest increase was the 79.1 per cent for depreciation. This reflected the high capital costs of the new multiplexes and the modernization by MGM Cinemas and Odeon of some of their older cinemas. Advertising and publicity costs increased by more than 40 per cent. Table 11 of Appendix 5.2 shows that from 1989 the new multiplex operators spent far more on these items than MGM Cinemas and Odeon, which responded with increased expenditure, although not on the scale of their new competitors. Staff costs increased by more than 25 per cent and other operating costs per seat by almost 15 per cent. [

Details omitted. See note on page iv.

] Natl Amusements benefits from not having to bear the costs of a head office; it is managed from the office of National Amusements Inc in Dedham, Massachusetts.

5.42. We asked the leading exhibitors to give us details of their average number of employees. There are many part-time employees, and the companies have not dealt with them on a consistent basis. It is therefore only possible to make broad comparisons between the exhibitors. Nevertheless, on various measures of productivity (admissions and seats per employee, employees per screen) the new multiplex operators appear to perform better than the traditional circuits which have fewer modern cinemas.

Admissions

5.43. All the leading exhibitors except MGM Cinemas have increased the number of seats over the five years, and all have increased the number of screens. When considering profit per seat, one must look not only at profit per admission but also the number of admissions per seat. The number of admissions and the average (not year-end) number of seats for the five leading exhibitors is set out in Table 5.12 and for each of the exhibitors in Table 13 of Appendix 5.2. Over the five years admissions increased by 29.0 per cent and the number of seats by 27.7 per cent, so that admissions per seat in 1993, after a decline from 1990 to 1992, were little changed from 1989.

TABLE 5.12 The five leading exhibitors: average admissions per seat, 1989 to 1993

						'000
	1989	1990	1991	1992	1993	
Admissions	66,413	70,820	74,215	75,252	85,666	
						Units
Average number of seats	257,576	291,070	306,364	320,806	328,797	
Admissions per seat	258	243	242	235	261	

Source: MMC using the leading exhibitors' data.

Capital employed

5.44. Table 5.13 gives the numbers of cinemas and screens of the five leading exhibitors at the end of each of their accounting periods completed in the five years to 1993 and their total capital expenditure (the capital expenditure of the individual exhibitors is given in Table 13 of Appendix 5.2). Capital expenditure reached a peak in 1989 but, despite a subsequent decline in expenditure and the closure of a number of older cinemas by MGM Cinemas and Odeon, the leading exhibitors except MGM Cinemas are still increasing their facilities. MGM Cinemas' expenditure of £26 million on acquisitions in 1989 and 1990, which added five cinemas and ten development sites to its circuit, has not been included in the capital expenditure in Table 5.13. The five leading exhibitors incurred capital expenditure of £388.2 million during the six years 1988 to 1993.

TABLE 5.13 The leading exhibitors: facilities and capital expenditure, 1988 to 1993

	<i>Numbers at period end</i>					
	1988	1989	1990	1991	1992	1993
<i>Cinemas</i>						
MGM Cinemas	143	146	138	138	133	127
Natl Amusements	3	7	7	8	9	10
Odeon	72	74	75	74	72	72
UCI	11	17	21	23	25	25
Warner Theatres	<u>1</u>	<u>3</u>	<u>5</u>	<u>6</u>	<u>7</u>	<u>9</u>
	<u>230</u>	<u>247</u>	<u>246</u>	<u>249</u>	<u>246</u>	<u>243</u>
<i>Screens</i>						
MGM Cinemas	386	396	400	443	429	416
Natl Amusements	37	89	89	101	113	127
Odeon	205	233	262	289	310	321
UCI	91	146	186	205	217	217
Warner Theatres	<u>5</u>	<u>26</u>	<u>48</u>	<u>57</u>	<u>64</u>	<u>84</u>
	<u>724</u>	<u>890</u>	<u>985</u>	<u>1,095</u>	<u>1,133</u>	<u>1,165</u>
						<i>£'000</i>
Capital expenditure	69,556	104,360	67,315	61,679	47,812	37,502

Source: The five leading exhibitors.

5.45. Table 14 of Appendix 5.2 gives the average capital employed for each of the five leading exhibitors, and the capital employed per seat. MGM Cinemas and Odeon still have a number of older, traditional cinemas (many of which are listed buildings) with low historical costs, which are heavily depreciated, and this is reflected in their lower capital employed per seat than the new multiplex operators. Their expenditure on new and refurbished cinemas has reduced the differences between them and the new multiplex operators.

Return on capital employed

5.46. Table 5.14 sets out average operating profit per admission, admissions per seat and average capital employed per seat for each of the leading exhibitors for the five years from 1989 to 1993, together with their return on average capital employed.¹

¹Table 5.14 shows the components of ROCE listed in paragraph 5.37 (with one of the ratios, capital employed per seat, inverted). For example, for the five leading exhibitors in aggregate, ROCE in 1993 was $0.64 \times 261 \div 1,091 = 0.153$ or 15.3 per cent.

TABLE 5.14 The five leading exhibitors: components of profitability, 1989 to 1993

	<i>Financial years ending in</i>				
	1989	1990	1991	1992	1993
<i>£</i>					
<i>Operating profit per admission</i>					
MGM Cinemas[
Natl Amusements			<i>Figures omitted.</i>		
Odeon			<i>See note on</i>		
UCI			<i>page iv.</i>		
Warner Theatres]					
<i>Average</i>	0.28	0.40	0.54	0.50	0.64
<i>Units</i>					
<i>Admissions per seat</i>					
MGM Cinemas[
Natl Amusements			<i>Figures omitted.</i>		
Odeon			<i>See note on</i>		
UCI			<i>page iv.</i>		
Warner Theatres]					
<i>Average</i>	258	243	242	235	261
<i>£</i>					
<i>Capital employed per seat</i>					
MGM Cinemas[
Natl Amusements			<i>Figures omitted.</i>		
Odeon			<i>See note on</i>		
UCI			<i>page iv.</i>		
Warner Theatres]					
<i>Average</i>	838	963	1,017	1,053	1,091
<i>per cent</i>					
<i>ROCE</i>					
MGM Cinemas[
Natl Amusements			<i>Figures omitted.</i>		
Odeon			<i>See note on</i>		
UCI			<i>page iv.</i>		
Warner Theatres]					
<i>Average</i>	8.5	10.1	13.0	11.2	15.3

Source: MMC using the leading exhibitors' data.

5.47. For the exhibitors taken together, operating profit per admission improved from 28p to 64p, an increase of more than 125 per cent. This was partly offset by an increase of 40 per cent in capital employed per seat from £838 to £1,091. Admissions per seat, after declining from 1990 to 1992, recovered to their 1989 levels; over the five years the growth in admissions was closely matched by the increased number of seats. Overall, ROCE improved from 8.5 to 15.3 per cent.

5.48. Table 5.14 reveals how the financial performance of the new multiplex operators-Natl Amusements, UCI and Warner Theatres-differs from that of the traditional operators. Even so there are differences between the multiplex operators. UCI is outstanding for the number of admissions per seat; in 1993 it was more than 20 per cent ahead of its nearest competitor. This intensive use of its capacity partly compensates it for having the highest capital cost per seat of all the exhibitors. However, its increasing staff costs and other overheads have led to a fall in profitability in 1992 and 1993. Natl Amusements has benefited from its high profits on concessions and low operating costs, particularly staff costs. Warner Theatres has changed during the five years from the operator of a loss-making West End cinema, used mostly for its parent studio's films, into an increasingly profitable multiplex operator.

5.49. Overall, the ROCE of the multiplex operators has not yet reached their target rates of return and their operating profits have in some years been insufficient to cover their interest costs.

5.50. MGM Cinemas and Odeon, the traditional exhibitors, generally had a lower profit per admission than their newer competitors. They had lower overheads per seat, but this advantage was offset by having

fewer admissions per seat than their new competitors, who also had higher concession profits per admission. Their principal advantage is a lower capital employed per seat, a reflection of their large numbers of old cinemas with low historical costs, now largely depreciated, but this advantage has been reduced as they have responded to the construction programmes of their new multiplex competitors with building projects of their own. Odeon's ROCE has fallen from almost [*] per cent in 1989 to around [*] per cent, still comfortably the highest of the major exhibitors.

*Figures omitted. See note on page iv.