



BUSINESS AND MANAGEMENT (PRINCIPAL)

9771/02

Paper 2 Strategic Decisions

May/June 2015

3 hours

Additional Materials: Answer Paper/Booklet



READ THESE INSTRUCTIONS FIRST

If you have been given an Answer Booklet, follow the instructions on the front cover of the Booklet.

Write your Centre number, candidate number and name on all the work you hand in.

Write in dark blue or black pen.

You may use an HB pencil for any diagrams or graphs.

Do not use staples, paper clips, glue or correction fluid.

DO NOT WRITE IN ANY BARCODES.

Answer **all** questions.

At the end of the examination, fasten all your work securely together.

The number of marks is given in brackets [] at the end of each question or part question.

The syllabus is approved for use in England, Wales and Northern Ireland as a Cambridge International Level 3 Pre-U Certificate.

This document consists of **8** printed pages.

Cineworld Group plc (CINE)

Introduction

The UK cinema market is dominated by 3 companies. These are Cineworld Group (CINE), Odeon and Vue. They account for 70% of the total market for cinema admissions. CINE has the highest share of these admissions with 26.4% but it has slightly fewer screens and cinemas than Odeon. 5

CINE consists of Cineworld Cinemas and Picturehouse. Cineworld Cinemas has 80 sites, of which 77 are multiplex with 5 screens or more. It has 4 of the top 10 highest grossing cinemas in the UK and had 47.8 million admissions in 2012. CINE acquired Picturehouse in 2012. This has been kept as a separate specialist cinema chain. It has 21 cinemas, 19 of which have fewer than 5 screens. 10

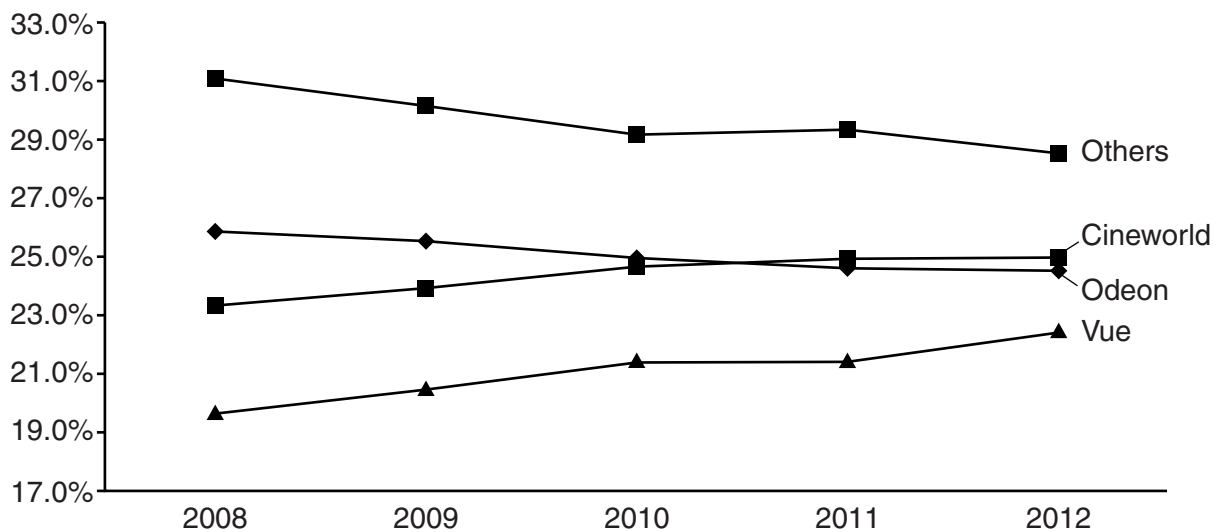


Figure 1: Market share for the largest cinema companies

Objectives

The 2012 CINE Annual Report states that the Group's objectives are to:

- A: develop and improve its service to its customers
- B: grow ticket revenues
- C: increase retail spend per customer (food/snacks and drinks) 15
- D: increase other revenue streams (e.g. advertising)
- E: grow the business through selective new openings, expansions and acquisitions
- F: look to expand into complementary markets
- G: use technology to improve its customers' experience and the efficiency of its operations.

Technological advances 20

In mid 2012 the conversion to digital projection was completed in all the cinemas except for the newly acquired Picturehouse. This involved a high initial outlay but the picture quality is considerably better. 3D is a growing market and more films are being released in this format giving customers an increased choice. CINE has also invested heavily in its online presence and the website now accounts for approximately 20% of bookings. Another innovation has been the online service called 'MyCineworld'. Customers register for this service and provide their basic details and in return receive targeted promotions and offers. Technology is likely to have a long term impact on unit costs and end user experience. 25

Growing the business

CINE purchased Picturehouse for £47.3m. This cinema chain operates in a different niche and primarily appeals to a mature audience. Picturehouse market share was 1.7% in 2012. It will continue to operate under its own brand with separate management. The aim is to open more Picturehouse cinemas. They offer targeted films with a bar and a range of cooked food. The acquisition of Picturehouse has led to a Competition Commission investigation into possible cinema monopolies in 3 locations in the UK.

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Expansion is not limited to the purchase of Picturehouse. A new 7-screen cinema has recently been opened by CINE in Aldershot and the Group is looking to expand in the Irish market. It currently owns 1 substantial cinema in Dublin and is keen to explore future expansion in this market. Anthony Bloom (Chairman of CINE) states in the Annual Report: 'I am very excited about the growth prospects for the Group'.

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Sites	Year opened	Screens
Aberdeen Union Square	2009	10
Witney	2009	5
Greenwich 02	2010	11
Leigh	2011	7
Aldershot	2012	7

- Average net capital invested £2.3m
- Average payback of 2.7 years
- All sites have shown growth in cinema attendance
- All 25 year leases

Table 1: Cineworld Cinemas new site analysis

Retail spend per customer

Retail spending on food and drinks per customer contributed £82.8m of revenue to CINE in 2012. Retail spend per customer was £1.72 in 2012 compared with £1.69 the previous year. Customers are very value conscious due to the difficult economic climate and CINE has responded by instigating a number of special offers and deals. CINE has also opened Starbucks franchises within 2 of its cinemas. It is estimated by leisure industry analysts that the price elasticity of demand for food and drinks within cinemas is approximately -1.36. The management at CINE are very keen to increase the average retail spend as it is their second biggest source of income.

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	52 week period ended 27 December 2012			52 week period ended 29 December 2011
	Group Total	Picturehouse Total	Cineworld Total	Total
Admissions	48.0 m	0.2 m	47.8 m	48.3 m
	£ m	£ m	£ m	£ m
Box office	252.6	1.0	251.6	242.1
Retail	82.8	0.5	82.3	81.6
Other income	23.3	1.0	22.3	24.3
Total revenue	358.7	2.5	356.2	348.0

Table 2: CINE revenues

Liquidity

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One measure that is used to assess the viability of a business is its liquidity. Banks and suppliers are interested in this measure as it can illustrate the ability of businesses to pay their short term debts.

Differences of opinion exist regarding the importance of liquidity ratio results. According to one stockbroker CINE has relatively poor liquidity and it should consider strategies to improve its position. On the other hand, some business analysts who are specialists in the leisure industry have stated that cinema businesses have regular cash inflows and thus the current ratio and acid test ratio results can be misleading.

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Shareholders and future prospects for CINE

In recent years shareholders in CINE have experienced an increase in share price. As at 27 December 2012 the share price was £3.00. The 2012 dividend per share was 11.8p (11.0p in 2011). The company has maintained its level of admissions despite the economic downturn and the average ticket price paid was £5.26 in 2012, up from £5.01 in 2011.

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Cinema visits are seen as an 'affordable treat' and this has defied some sceptics who predicted that the days of the cinema were numbered due to DVD rentals, movie streaming and pressure on disposable incomes. Other factors have helped cinemas, such as the increase in the number of 3D movie releases and a steady flow of popular new films. One area of concern for CINE has been the income from cinema advertising which has fallen slightly over the past few years.

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It is unclear how CINE will perform in the future. Stockbroker analysts generally remain optimistic about the company but one broker has reduced its view from neutral to sell.

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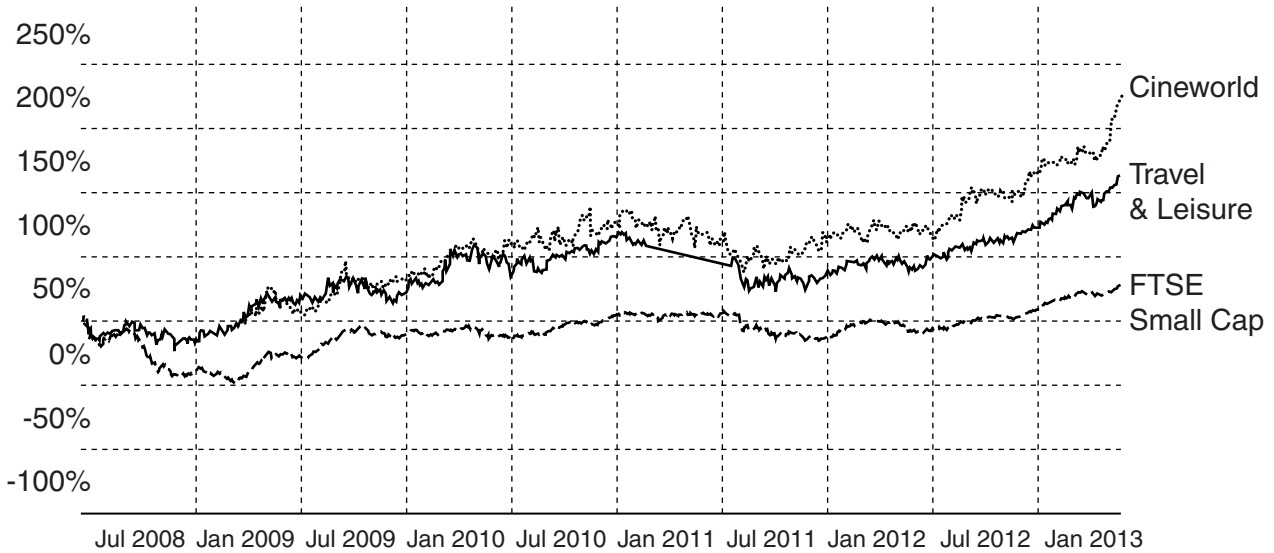


Figure 2: CINE 5 year relative share price

Inflationary pressures

Even though the UK economy has been through a difficult period, inflation has remained relatively high. In June 2013 the Consumer Price Inflation (CPI) is 2.7% and Retail Price Inflation (RPI) is 3.1%. The concern for some economists is that inflation may spike higher as the worst of the economic crisis may be over. For several years wage increases in the UK have not kept pace with inflation.

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Percentage change over 12 months

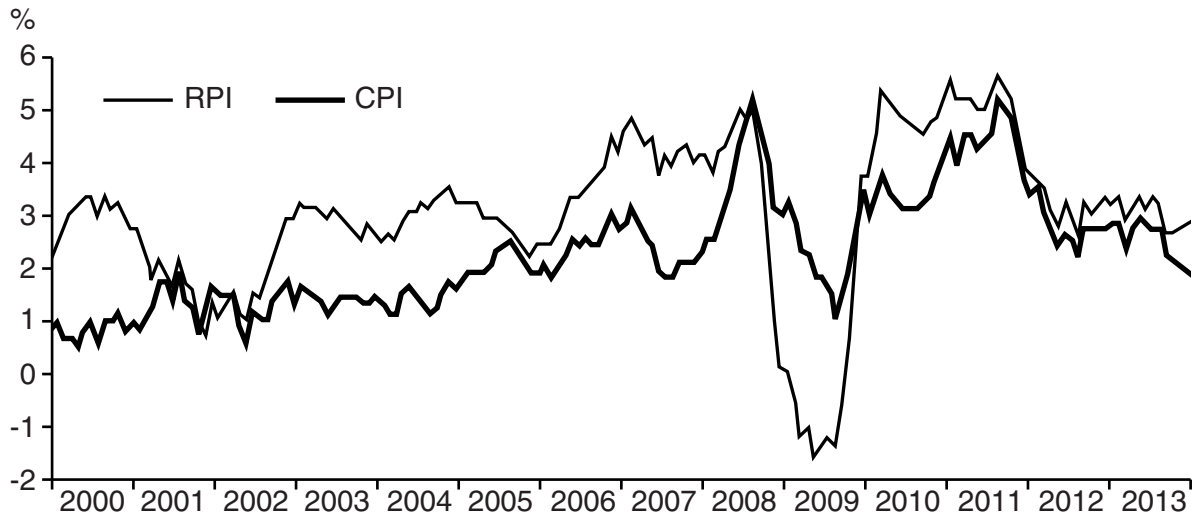


Figure 3: CPI and RPI inflation

-	27 December 2012 £m	29 December 2011 £m
Revenue	358.7	348.0
Cost of Sales	(263.9)	(261.5)
Gross profit	94.8	86.5
Other operating income	0.3	0.4
Administrative expenses	(50.9)	(44.3)
Operating profit	44.2	42.6
Net finance expense	(5.7)	(9.2)
Profit before taxation	38.5	33.4
Tax charge	(10.8)	(9.5)
Profit attributable to equity holders	27.7	23.9
Earnings per share	19.4p	16.8p
Share price	300p	250p

Table 3: CINE income statement (extract) and share price

	27 December 2012		29 December 2011	
	£m	£m	£m	£m
Non-current assets				
Property, plant and equipment		160.0		124.3
Goodwill		236.7		217.1
Intangible assets		15.7		0.3
Investments in equity-accounted investee		0.7		0.8
Other receivables		1.4		1.4
Employee benefits		4.4		2.0
Deferred tax assets		9.9		12.0
Total non-current assets		428.8		357.9
Current assets				
Inventories		3.8		2.1
Trade and other receivables		34.3		26.6
Cash and cash equivalents		10.9		5.5
Total current assets		49.0		34.2
Total assets		477.8		392.1
Current liabilities				
Interest-bearing loans, borrowings and other financial liabilities		(8.1)		(6.9)
Trade and other payables		(72.7)		(52.9)
Current taxes payable		(4.7)		(4.8)
Provisions		(0.3)		(2.3)
Total current liabilities		(85.8)		(66.9)
Non-current liabilities				
Interest-bearing loans, borrowings and other financial liabilities		(129.7)		(100.0)
Other payables		(53.3)		(53.3)
Government grants		(1.9)		–
Provisions		(11.1)		(9.3)
Deferred tax liabilities		(7.4)		(2.3)
Total non-current liabilities		(203.4)		(164.9)
Total liabilities		(289.2)		(231.8)
Net assets		(188.6)		160.3
Equity attributable to equity holders of the Company				
Share capital		1.5		1.4
Share premium		188.1		171.8
Translation reserves		1.3		1.8
Hedging reserves		(3.5)		(3.4)
Retained earnings/(deficit)		1.2		(11.3)
Total equity		188.6		160.3

Table 4: Cineworld Group Balance Sheet (extract)

Read all the case study material and then answer all the following questions.

Section 1

- 1 (a) Calculate the price/earnings ratio as at 27 December 2012. [3]
- (b) Calculate the gearing ratio as at 27 December 2012. [3]
- (c) Comment on the significance to CINE shareholders of the results obtained in **1(a)** and **1(b)**. [6]
- (d) Analyse the liquidity position of CINE as at 27 December 2012. [13]

Section 2

- 2 Discuss how a sustained increase in the rate of inflation could impact upon the success of CINE. [25]
- 3 Recommend and justify a strategy that CINE could pursue to profitably increase retail spend per customer. [25]
- 4 One of CINE's objectives is to 'grow the business through selective new openings, expansions and acquisitions'. (Line 17)
- Discuss whether you consider this to be an appropriate objective for CINE. [25]

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