

Chapter 13: Recreational Businesses

This major group includes establishments engaged in providing amusement or entertainment services.

Movie Theaters

SIC: 7832 NAICS: 512131

This category includes commercially operated theaters primarily engaged in the indoor exhibition of motion pictures. Drive-in theaters are not included in this classification.

Description of Business

Initially, the majority of movie theaters were owned by the dominant movie producers. Government intervention ended this practice in 1949, in an effort to curb monopolistic activity. Until the 1970s, the majority of movie theaters featured one screen. The emergence of multiplexing assisted the industry in achieving sustainable cash flows. A trend of over-construction began to plague the industry, causing a flood of screens during the 1980s. As a result of this activity, owners were forced to cut prices to remain competitive.

General Industry Information

The revenue sources for movie theaters include ticket sales, concession sales, and advertisements. Typically, production companies receive a fraction of the ticket sales. Concession sales and advertisement revenue belong exclusively to the movie theater.

Current leaders in the industry include Regal Entertainment Group, AMC Entertainment Inc., and Cinemark USA. Combined, these top three companies controlled approximately 33% of the industry's 36,000 movie screens in 2004 (source: National Association of Theatre Owners). The industry is notably sensitive to changes in households' disposable income, which is affected during periods of high unemployment and interest rates.

Financial Performance Ratios Table 13-1: Comparable Return on Sales Ratios

Ratio	Formula	Explanation	Small Theater			Medium Theater			Large Theater		
			Q1	Q2	Q3	Q1	Q2	Q3	Q1	Q2	Q3
Gross margin	$\frac{\text{Gross profit}}{\text{Sales}}$	Captures the relationship between sales and manufacturing costs.	54%	70%	78%	51%	52%	54%	17%	42%	60%
Operating margin EBITDA	$\frac{\text{Operating income}}{\text{Sales}}$	Firm's profitability from the operations of its "core" business <u>without</u> regard to: investment policy (income from affiliates or sale of assets), financing policy (interest expense), tax position.	15.5%	17.2%	20.2%	14.0%	15.5%	19.5%	15.2%	15.9%	17.4%
Margin (Earnings before interest and tax or EBIT)	$\frac{\text{EBIT}}{\text{Sales}}$	Firm's profitability from the operations, independent of firm's financing and tax position.	13.9%	16.6%	19.8%	8.9%	10.8%	12.5%	7.4%	8.2%	9.6%
Pretax Margin	$\frac{\text{EBT}}{\text{Sales}}$	Firm's profitability from the operations, independent of firm's tax position.	13.4%	16.1%	19.5%	8.3%	10.6%	11.8%	2.6%	4.6%	5.4%
Profit Margin	$\frac{\text{Net income}}{\text{Sales}}$	Indicates return on sales, after accounting for taxes, costs, interest, and investment policy.	8.0%	9.7%	11.7%	5.0%	6.4%	7.1%	2.0%	3.9%	4.2%

Source: Stephen Bethel, *The Valuation of Movie Theater Operations*

Table 13-2: Profitability of Concessions

Ratio	Formula	Small Theaters			Medium Theaters			Large Theaters		
		Q1	Q2	Q3	Q1	Q2	Q3	Q1	Q2	Q3
Concessions Sales	$\frac{\text{Concession Sales}}{\text{Total Sales}}$	29.04%	33.18%	35.60%	24.42%	26.70%	28.33%	26.35%	28.96%	31.10%
Cost of Concessions	$\frac{\text{Cost of Concession Sales}}{\text{Concession Sales}}$	17.96%	21.01%	28.05%	18.60%	19.07%	19.55%	11.00%	12.88%	14.72%
Gross Margins	$\frac{\text{Net Concession Income}}{\text{Concession Sales}}$	73.48%	78.99%	81.11%	80.50%	80.93%	81.47%	84.89%	87.12%	88.27%

Source: Stephen Bethel, *The Valuation of Movie Theater Operations*



Business Valuation Formulas

Table 13-3: Theater Business Valuation Rules of Thumb

Financial Measure	Multiple*
Revenue (business only, no real estate)	0.27-0.5 times (0.4 average)
Owner's Discretionary Cash Flow (business only, no real estate)	1.3 to 4 times
EBITDA Multiples (including real estate)	7-9 times

*Multiples need to be adjusted for working capital



Equipment Valuation and Real Estate Rental Formulas

Equipment

OLV is typically 15-25% of retail value. Digital operations sell for significantly more than analogue systems.