

## **CINEWORLD/CITY SCREEN MERGER INQUIRY**

### **Summary of hearing with Vue held on 3 June 2013**

#### **Background**

1. Vue said that it was the third largest cinema operator in the UK, with a share of about 22.5 per cent of box office revenues. Vue acquired CinemaxX, a circuit in Germany in 2012 and in May 2013 acquired the second-largest circuit in Poland, Multikino, which included a small distribution business that was operating exclusively in Poland. 99.5 per cent of all revenues came from the cinema-exhibition business.
2. Vue aimed to provide content that was attractive to the widest possible range of cinemagoers, of all ages and tastes, and to maximize occupancy of its screens. It might screen 200 to 250 mainstream films a year and a further 50 with a specific appeal, such as children's films, classics or movies that might attract a smaller audience. Vue used email notifications to communicate with customers. It did not currently run a membership scheme although it planned to introduce one in the near future.

#### **Revenues and earnings**

3. Box office represented about 70 per cent of revenues; food and beverages about 25 per cent, and screen advertising around 5 per cent. This did not vary strongly by cinema. Margins were highest in the food and beverages segment and Vue charged as much as it could for these products without discouraging purchases. It would expect that changes in the prices of food and beverages would affect people's decisions to purchase those products, but not their choice of whether to come to the cinema. Vue had 20 to 25 ticket price categories across its sites, including supplements for VIP seats and 3-D movies.

#### **Developments in the market**

4. Digitization had had a profound impact on the cinema exhibition industry, giving a high-quality experience to cinemagoers and enabling 3-D to happen and to grow. It also made it extremely easy to switch films between screens in response to the level of demand for them and increased the range of material that could be shown, including live streaming of events, and short runs of less-popular films for which there was a small local market.
5. Increasingly films could be delivered via satellite, thus eliminating the delay of sending a physical package. Digitization also reduced the amount of space needed for projection booths, therefore increasing the amount of space for seats and meaning that cinemas could be developed on slightly smaller sites.
6. Digitization cost about £60,000 per unit.
7. 3-D was another important development in the market. Around 25 per cent of tickets sold in 2012 would be 3-D tickets—up from 16–17 per cent in the previous year.
8. It was unhelpful to categorize films as commercial or non-commercial. All films could make money: the difference was that some would attract a larger audience than

others. The task of the programmer was to match films to where they were likely to do best. Vue was encouraging distributors to see digitization as an opportunity to get their films into more locations than before and therefore to make films available for short runs in places that they previously would not have seen as appropriate markets.

9. The advent of mechanisms for people to watch movies at home had had a positive effect on business, because such mechanisms encouraged people to watch films more generally, including in cinemas. Vue considered that it was competing with other out-of-home experiences such as going to restaurants, bars, bowling alleys, concerts and live sports rather than with means of watching films at home.
10. Vue had one 'luxury' auditorium at its cinema at the Westfield shopping centre, with its own bar and more leg-room. It had found it useful also for running conferences and events but occupancy rates were not high enough. Vue was not planning to adopt this model more widely in the UK. It did, however, have VIP seats in all its auditoria, which had proved very popular.

### **Competition with the merger parties and others**

11. Vue monitored other cinemas' programming, market share, box office revenues and both ticket prices and prices of ancillary products in all areas where it had a cinema. As a rule of thumb, Vue saw each cinema's market as covering a 20-minute drive-time around it, and viewed every cinema within that isochrone as a competitor. It did not distinguish between multiplex or art-house cinemas in choosing which to monitor. Very few cinemas were strictly art-house, and those were subsidized by the BFI. There was a strong overlap between Vue and both Picturehouse and Cineworld in terms of films shown. Vue did not know whether this had increased over time.
12. Vue's decisions about what films to show were not based on what other cinemas were showing. In relation to films that likely would attract a smaller audience it might be difficult to obtain a film that was already showing in other cinemas in the area, because distributors preferred not to split the audience. This was because in relation to such films distributors still measured themselves against KPIs for average takings per screen, even though this made less sense now that it was cheap and easy to produce digital copies of films and show them over a larger number of screens. Distributors might seek to get a good deal with a chain that was able to guarantee showing the film in a number of cinemas, particularly as the reduced number of parties with which it had to enter into agreements lowered transaction costs.

### **Market entry**

13. Vue would open four cinemas this year: Cramlington, Bicester (previously an Apollo site), Gateshead and Glasgow Fort. It planned to open a further three or four in the following year and was looking to continue to expand in smaller markets all around the UK—opening cinemas that were smaller in terms of footprint but not in terms of number of auditoria or seats: they would tend to have seven to eight screens and 1,000 seats. While it would also open large cinemas, it was important that the cost of rent did not outweigh income.
14. Vue was also interested in making further acquisitions and in expanding into Europe. It expected considerable consolidation in the area, similar to what had happened in the USA in recent years, prompted by the economies of scale that could be gained.

15. Vue had not been interested in acquiring Picturehouse largely because it operated cinemas in old buildings which entailed extra maintenance costs and, sometimes, planning restrictions.
16. New cinemas tended to be built as part of a retail development, planning consent for which often included the obligation to develop a leisure facility. The main barrier to a new operator would be to gain credibility with the relevant developer. However, there was an example of a developer managing the cinema itself when existing cinema operators declined to bid for the opportunity, which indicated that the appropriate expertise could be hired by new entrants. It was possible to make deals with landlords so that rent would vary according to the revenue of the cinema, so protecting against volume risk. This made it difficult to give the cost of setting up a cinema, but a seven- to eight-screen cinema would cost £4–4.5 million to build. It would take an average of 2–2.5 years from the identification of the site through to the opening of a new cinema.
17. It was far easier for an existing operator to expand than for a new operator to enter. Vue thought it most likely that any new entrant to the UK market would be an existing cinema operator from overseas.
18. Vue was backed by private equity investors. It had not experienced any difficulty in raising funds for its expansion plans.

### **Impact of the merger**

19. Vue expected to experience even greater difficulty in gaining access to smaller-release films following the merger. It already experienced difficulty getting access to the films that Picturehouse distributed and expected to now receive less favourable treatment than Cineworld. This could lead to those films becoming more expensive for customers, although Vue did not expect the merger to result in widespread price increases. Some local areas would be more affected than others.