

## **Wednesdays at Cinemex**

Revised: August 28, 2002

In April 2001, Matt Heyman, co-founder of Cinemex, the largest chain of movie theaters in Mexico City, looked out the window of his office and pondered the future of his company. In just seven years, Heyman and his partners had nurtured Cinemex from a student idea into the largest theater chain in Mexico City, but they faced new challenges every day. Many of these challenges came from competitors. For years competitors ran old, poorly-maintained theaters, but in recent months they had begun to imitate Cinemex's top-of-the-line exhibition venues. Their latest tactic: offering two tickets for the price of one on Wednesdays. Heyman wondered whether Cinemex should offer a similar deal, or instead rely on the Cinemex brand and hold the line on price.

### **Movie Exhibition**

Movie theaters – known as exhibitors in the film business – are the last link in the chain of events for a theatrical release:

Story Rights Acquisition → Pre-production → Principal Photography → Post-production → <b>Exhibition</b>
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Exhibitors worldwide compete through their locations, their choice of films, and the quality of experience they give their customers. Heyman calls it a straight EBITDA business. Revenue consists primarily of ticket sales (box office) and concessions (food and drink sales). Expenses include film rental (the cost of renting the movie from the distributor, generally a percentage of ticket sales), the cost of facilities, payroll, and the cost of goods sold at concessions. See Exhibits 1 and 2.

### **History of Cinemex**

Cinemex started with a student business plan. Heyman and two of his business school classmates, Adolfo Fastlich and Miguel Angel Davila, speculated that Mexico was ready for world-class movie theaters. Decades of regulation, including fixed (low) ticket prices, had produced an installed base of old and dilapidated theaters. When the regulations were lifted, Heyman and his colleagues decided that Mexico City offered an attractive market for a high-end chain of theaters. Rejecting job offers from Blockbuster, Goldman Sachs, McKinsey, Pepsico, and others, they took their plan on the road in search of investors.

In 1994, they secured \$21.5m in equity financing from JPMorgan Partners and a partnership of the Bluhm family of Chicago. The deal is generally acknowledged to be

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the largest venture capital start-up in Mexican history. In December the economy collapsed, with real output falling by 15% and the value of the peso falling in half between early December 1994 and mid-1995. Although this made Mexico a less-attractive market in the short run, it also made land cheaper and scared off potential competitors who had seen the same opportunity. Cinemex opened its first complex, Cinemex Altavista, in August 1995.

From the start, Cinemex followed a strategy of differentiation through branding. Since all theaters have access to the same films, and in some cases the same or similar locations, Heyman felt that the greatest leverage was in the quality of the theater itself. The low quality of existing theaters presented an opportunity to develop a brand associated with quality, including bigger and better screens, complete carpeting in all rooms, well-illuminated interiors, emergency lights on the floors, modern light cards for promotional placards, and attractive marquees. These amenities, considered standard for decades in most American theaters, were seen as almost revolutionary when first introduced in Mexico. The candy shops were the same in all the complexes, with large displays and well-maintained cash registers that allowed for quick service. Management trained its employees to be courteous and helpful. It was also the first movie chain in the world to introduce its own system for customers to purchase and reserve tickets by telephone and the Internet, and was the only chain in the world with 100% digital sound.

This commitment to quality was rewarded by the market. By 2000, Cinemex had captured 52% of Mexico City's movie-going market and 23% of Mexico's national cinema market. The National Organization of Theater Owners named Cinemex "International Exhibitor of the Year" in 2001. By mid 2002, the company had 349 screens in 31 locations and had generated a reported compound annual rate of return well in excess of 20% for its initial investors.

### **2-for-1 Wednesdays**

In the spring of 2001, Cinemex's competitors began offering a special deal: any customer who purchased a ticket to see a film on a Wednesday (traditionally a slow day at the box office) would receive a second ticket at no additional charge. This ploy cut into Cinemex's attendance figures (Exhibit 3). On five of the first six Wednesdays after the deal's introduction, Cinemex's attendance was less than in the same week during the previous year.

Heyman faced a difficult decision. Should he offer his own two-for-one deal on Wednesdays? This might raise attendance, but since many tickets would be given away for free, it might also reduce ticket revenues. Or should he do nothing, hoping that the appeal of Cinemex's customer service package would eventually bring customers back?

Heyman's first step was to review his attendance data. What made this difficult was that week-to-week attendance was highly variable, depending on (among other things) the time of year, the popularity of current films, local weather conditions, and the timing of holidays. The question was how to disentangle the impact of these factors from those of

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price. After waiting a few months, Heyman decided to match his competitor's offer beginning Wednesday, August 29, 2001.

### **Postscript**

In July 2002, Heyman announced the sale of Cinemex to Canadian buyout firm Onex and Los Angeles-based Oaktree Capital Management. He planned to focus on Digital Projection Partners, a startup he formed in 2001 that was in discussions with MPAA companies (movie studios) regarding the funding and implementation of the studios' digital projection initiative.

### **Questions for Analysis**

- (a) What opportunities made Cinemex's success possible? Did these opportunities last?
- (b) How large was the impact of competitors' 2-for-1 pricing on Cinemex's ticket sales?
- (c) How large was the impact of Cinemex's own 2-for-1 deal on its own ticket sales? On its average ticket price? On total revenue?
- (d) Why might a 2-for-1 deal be better for exhibitors than a straight reduction in price?
- (e) Bottom line: Was Heyman right to match the 2-for-1 pricing?

### **Notes**

*This case was prepared by Kenneth Goldman under the supervision of David Backus for the purpose of class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. The author thanks Matthew Heyman for data and advice. © 2002 NYU Stern School of Business.*

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**Exhibit 1**  
**Cinemex Income Statement, 2000**

**REVENUE**

Gross Box Office	594,742,302	60.6%
Copyright Tax	9,813,248	1.0%
Net Box Office	584,929,054	59.6%
Net Concession	311,450,504	31.7%
Screen Advertising	79,810,789	8.1%
Other Operating Revenue	5,364,545	0.5%
<b>TOTAL NET REVENUE</b>	<b>981,554,892</b>	<b>100.0%</b>

Film Rental	236,821,568	24.1%
Advertising	8,962,418	0.9%
Concession COGS	84,202,821	8.6%
<b>TOTAL COST OF SALES</b>	<b>329,986,807</b>	<b>33.6%</b>

<b>GROSS OPERATING PROFIT</b>	<b>651,568,085</b>	<b>66.4%</b>
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Theatre Payroll	85,126,970	8.7%
Occupancy Expense	136,066,106	13.9%
Supplies and Services	70,845,999	7.2%
<b>TOTAL OPERATING EXPENSES</b>	<b>292,039,075</b>	<b>29.8%</b>

<b>THEATRE LEVEL CASH FLOW</b>	<b>359,529,011</b>	<b>36.6%</b>
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General and Administrative Exp.	59,402,976	6.1%
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<b>EBITDA</b>	<b>300,126,034</b>	<b>30.6%</b>
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Depreciation and Amortization	154,433,073	15.7%
<b>TOTAL NON OPERATING EXP.</b>	<b>154,433,073</b>	<b>15.7%</b>

<b>EBIT</b>	<b>145,692,961</b>	<b>14.8%</b>
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Financing cost	(25,742,282)	-2.6%
Other Income/(Expense)	9,544,710	1.0%
<b>NET INCOME BEFORE TAXES</b>	<b>129,495,389</b>	<b>13.2%</b>

Income tax	63,200,211	6.4%
<b>NET INCOME</b>	<b>66,295,178</b>	<b>6.8%</b>

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**Exhibit 2**  
**Cinemex Summary Statistics, 2000**

Film Rental (% of Net BO)	40.5%
Advertising Exp (% of Net BO)	1.5%
Concession COGS (% of concessions).	27.0%
Total Attendance	22,307,310
Average Ticket Price	\$26.66
Concession per Person	\$13.96
Other Revenue per Person	\$0.24
Payroll per Admit	\$3.82
Supplies and Services per Admit	\$3.18
Occupancy Expenses Per Admit	\$6.10
Revenue per staff hour	470.43
EBITDA per staff hour	143.84
Attendance per Screen/Week	1,807
Box Office per Screen/Week	\$48,186

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**Exhibit 3. Cinemex Wednesday Attendance and Average Ticket Price, 2000-2002.**

Week	Attendance (thousands)			Average Ticket Price (pesos)		
	2000	2001	2002	2000	2001	2002
1	45.2	100.5	142.9	18.8	21.1	16.4
2	55.3	55.1	99.0	18.6	20.9	16.2
3	58.2	61.7	104.4	18.6	20.9	16.2
4	56.7	54.3	90.9	18.6	21.0	16.2
5	56.8	55.0	90.8	18.7	20.9	16.2
6	51.5	56.7	75.6	18.7	21.0	16.3
7	52.5	93.9	61.3	18.6	20.8	16.3
8	51.0	58.5	79.7	18.7	21.0	16.3
9	58.4	50.9	76.9	18.8	21.2	16.3
10	49.4	49.9	76.6	18.8	21.1	16.4
11	48.3	75.5	68.7	18.8	20.7	16.3
12	37.7	131.5	128.9	18.7	29.3	16.2
13	43.5	47.0	172.7	18.8	21.3	16.4
14	52.2	47.1*	159.0	18.6	21.2*	16.3
15	51.6	108.3	82.1	18.5	21.2	16.1
16	107.4	86.9	80.0	18.7	21.0	16.2
17	75.7	42.5	73.1	18.7	21.0	16.3
18	40.2	37.9	161.8	18.7	20.9	32.5
19	65.8	37.3	80.7	18.6	21.2	16.3
20	49.7	52.0	111.2	18.3	20.8	16.3
21	47.3	47.8	143.5	18.3	20.9	16.3
22	56.9	55.8	116.3	17.7	20.7	16.2
23	47.3	53.4	104.5	18.4	20.8	16.3
24	53.0	59.8	95.8	18.7	20.7	16.4
25	78.6	57.1	124.5	18.6	20.6	16.5
26	77.8	73.2	113.5	19.9	20.7	16.5
27	76.6	92.1	150.9	20.0	21.1	16.6
28	111.9	115.1	153.1	19.7	20.9	16.5
29	113.4	116.3		19.5	20.8	
30	104.9	111.0		19.4	20.7	
31	107.2	123.2		19.5	20.9	
32	97.5	113.3		19.5	20.9	
33	98.2	102.1		19.6	21.0	
34	51.0	57.4		19.7	21.1	
35	49.0	59.6**		19.7	15.3**	
36	43.4	48.9		19.7	15.1	
37	43.2	57.4		19.7	15.3	
38	46.1	62.4		19.8	15.3	
39	45.4	55.2		19.8	15.3	
40	52.4	61.9		19.8	15.2	
41	49.6	61.8		19.8	15.2	
42	52.0	67.5		19.7	15.3	
43	44.3	66.7		19.7	15.2	
44	60.9	68.3		20.1	15.3	
45	43.7	69.3		19.7	15.2	
46	48.4	64.7		19.7	15.1	
47	44.9	52.6		19.8	15.0	
48	38.0	52.9		19.7	15.1	
49	41.2	74.7		19.6	15.1	
50	43.8	97.2		19.7	16.3	
51	66.9	128.9		21.1	16.3	
52	124.6	156.8		21.2	16.5	

Notes: Ticket prices are net of film rental. Week 12 in 2001 and Week 18 in 2002 were holidays and were not eligible for the 2-for-1 deal. \* Start of competitor 2-for-1 deal. \*\* Start of Cinemex 2-for-1 deal.