**QUESTION 1: SUGGESTED SOLUTION**

<table>
<thead>
<tr>
<th>Part (a)</th>
<th>Budget</th>
<th>Actual</th>
<th>Variance</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Tickets sold</td>
<td>1,029,000</td>
<td>984,900</td>
<td>-4.3%</td>
<td>1</td>
</tr>
<tr>
<td>Price per ticket</td>
<td>70.00</td>
<td>72.00</td>
<td>2.9%</td>
<td>1</td>
</tr>
</tbody>
</table>

**Ticket revenue variance analysis**

Sales volume variance: -3,087

Sales price variance: 1,970

**ROI00's**

Total revenue: 87,465

Beverage sales: 15,435

Average beverage revenue per patron: 15.0

Ticketing agents commission as % of revenue: 10.0%

**Revenue mix:**

<table>
<thead>
<tr>
<th>Source</th>
<th>Budget</th>
<th>Actual</th>
<th>Variance</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct ticket sales</td>
<td>360,143</td>
<td>275,733</td>
<td>-30%</td>
<td>1</td>
</tr>
<tr>
<td>Ticketing agent</td>
<td>668,857</td>
<td>709,167</td>
<td>4.6%</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>1,029,000</td>
<td>984,900</td>
<td>-4.3%</td>
<td>1</td>
</tr>
</tbody>
</table>

**Gross profit %**

58.1% vs 56.4%

**Gross profit on beverages**

50.0% vs 59.9%

**Musician & artist costs**

22,682 vs 24,518

8.1% vs 6.7%

**Marketing costs/revenue**

3.0% vs 3.3%

**Personnel expenses**

9,500 vs 10,140

4.6% vs 6.7%

**Total overheads**

44,007 vs 46,038

**Profit before tax**

7,196 vs 4,055

-43.6% vs -1,117%

**Comments**

- Ticket revenue, 1.4% down on budget mainly due to lower than budgeted attendances.
- Beverage revenue ahead of budget due to higher consumption per patron.
- More tickets were sold through ticketing agent than budgeted.
- This also resulted in higher cost of sales (commission paid).
- Overall GP % was below budget due to:
  - higher ticketing commission
  - higher musician & artist costs
  - Lower GP's from above factors partially reduced by higher beverage margins

**Overheads**

- Marketing costs were higher than budget, reasons unknown.
- Personnel expenses were significantly higher than budget, which is cause for concern.
- Total overheads 4.6% or R2,0m higher than budget mainly due to overrun on personnel costs.
Interest income 320  42

Lower than budgeted interest income is reflective of less free cash flow generated 1

Profit before tax was R3,2m below budget mainly due to:
- R2,0m overhead cost overrun
- R0,3m less interest income
- R0,8m less gross profit (higher musician costs)

The major causes for concern from the above analysis are:
- declining attendances at theatres
- cost controls and measures seem to be lacking

Profit before tax was R3,2m below budget mainly due to:
- R2,0m overhead cost overrun
- R0,3m less interest income
- R0,8m less gross profit (higher musician costs)

The major causes for concern from the above analysis are:
- declining attendances at theatres
- cost controls and measures seem to be lacking

Available marks 17
Maximum 12

Maximum part(a) 25

Part (b) 2005

Fixed costs
Contractors fees for new shows 1,180
New show stage props 750
Musicians and artists fees 25,574
Marketing costs 3,200
Depreciation 4,498
Personnel expenses 11,530
Rent of premises 23,707
Travelling & accommodation costs 4,775
Utility costs 1,770
Other overheads 3,975
Interest expense (NOTE) 1,650

Including fixed costs 2

82,609

NOTE Part A suggests interest expense is variable. Give mark if interest expense is omitted from fixed costs.

Variable expenses
Ticketing agents commission 10%

Ticket prices (Rands) 71.50

Revenue mix assumed in budget
Direct sales 35.0%
Ticketing agent 65.0%

Beverage margin per patron (Rands) 10.50

Contribution margin per patron
Direct sales 82.00
Ticketing agent 74.85

Breakeven number of tickets:

Formula: 65% * A * R82.00 + 35% * A * R72.85 = R82,609,000
Therefore, 78.8A = R82,609,000
A = 1,048,338

Therefore, number of tickets to breakeven 1,048,338

Available marks 13

Maximum 10
### Part (c)

<table>
<thead>
<tr>
<th></th>
<th>Budget 2005</th>
<th>Actual 2004</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tickets sold</td>
<td>1,146,600</td>
<td>984,900</td>
<td>16.4%</td>
</tr>
<tr>
<td>Price per ticket</td>
<td>71.50</td>
<td>72.00</td>
<td>-0.7%</td>
</tr>
<tr>
<td>Attendance levels/capacity utilisation</td>
<td>72.0%</td>
<td>67.0%</td>
<td>1</td>
</tr>
<tr>
<td>Ticket revenue (R000's)</td>
<td>81,982</td>
<td>70,913</td>
<td>15.6%</td>
</tr>
<tr>
<td>Increase (R000's) attributable to:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New theatre opening</td>
<td>5,909</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Higher attendance levels</td>
<td>5,733</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Lower ticket prices</td>
<td>-573</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Increase in 2005 ticket sales over 2004</td>
<td></td>
<td>11,069</td>
<td></td>
</tr>
<tr>
<td>Beverage revenue per patron</td>
<td>17.50</td>
<td>18.07</td>
<td>-3.2%</td>
</tr>
<tr>
<td>Beverage margin</td>
<td>60.0%</td>
<td>59.9%</td>
<td>1</td>
</tr>
<tr>
<td>% of total</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct ticket sales</td>
<td>35.0%</td>
<td>28.0%</td>
<td>1</td>
</tr>
<tr>
<td>Ticketing agent</td>
<td>65.0%</td>
<td>72.0%</td>
<td>1</td>
</tr>
<tr>
<td>Gross profit %</td>
<td>60.0%</td>
<td>56.4%</td>
<td>1</td>
</tr>
<tr>
<td>Overheads excluding depreciation</td>
<td>48,957</td>
<td>43,933</td>
<td>11.4%</td>
</tr>
<tr>
<td>Profit before interest/revenue</td>
<td>4.5%</td>
<td>7.6%</td>
<td></td>
</tr>
</tbody>
</table>

**Issues/assumptions requiring further consideration**

- Higher attendance levels at shows may be an unrealistic assumption given the declining attendance levels in 2004
- Why the decrease in ticket prices?
- Attendance level at new theatres may be lower than national average? Therefore, be more conservative in budget?
- Assumption that more ticket sales to occur directly may be unrealistic
- High breakeven point should be of major concern
- Marketing costs seem too low given that new theatres opening, higher increase?
- Given the history of poor cost control, are overhead forecasts reasonable?
- Depreciation increase may be too high [calculations seem incorrect]
- Budgeted revenue for beverages per patron is too conservative given the outcome in 2004 and likely impact of inflation
- Risk of patrons switching support to new location from old

**Available marks**

<table>
<thead>
<tr>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>13</td>
</tr>
</tbody>
</table>
Part (d)

Financial implications of owning theatres

<table>
<thead>
<tr>
<th>Description</th>
<th>1000's</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current average rental p.a. per theatre</td>
<td>1,813</td>
</tr>
<tr>
<td>Acquisition of theatre</td>
<td>15,000</td>
</tr>
<tr>
<td>Acquisition of sound equipment &amp; furniture/fittings irrelevant given that this occurs in any event</td>
<td></td>
</tr>
<tr>
<td>Likely annual interest cost of financing theatre @ 12.5% interest</td>
<td>1,875</td>
</tr>
<tr>
<td>Financial costs of leasing versus purchasing are similar</td>
<td></td>
</tr>
<tr>
<td>Loan (total) repayments over 10 year period?</td>
<td>5,419 k p.a.</td>
</tr>
</tbody>
</table>

Risks inherent in pursuing acquisition strategy

- Increased gearing, taking on R30m of debt                                  | 2      |
- Risk of theatres costing more than R30m to construct                       | 1      |
- Razzmatazz to assume ownership risks (area becomes unsuitable etc)        | 1      |
- In addition to interest cost, Razzmatazz needs to fund capital repayments from cash flows | 1      |

Conclusion

I agree with decision to pursue acquisition of theatres:
- 10 year lease agreement is a long term financial commitment therefore acquiring building is not significantly increasing company's existing commitment
- instead of paying rent, repay loan and own building
- provides security for company in terms of venue. If lease agreements terminate, business continuity may be threatened?
- existing cash flows strong enough to fund loan repayments (discontinue dividends)
- owning property diversifies business risk
- possible appreciation in value of building
- after 10 years lease costs to continue
- lease payments may continue to increase at say 9% p.a. whereas loan repayments are fixed

Reasoning

Alternate conclusion

Disagree with decision:
- Owning property is not their core business
- High fixed overheads places business is jeopardy if new theatre not viable. If renting, a settlement and alternate tenant could be found and negotiated
- Increased cash flow commitments may jeopardise further expansion plans
- Razzmatazz has managed to expand without owning property, so why change strategy?
- Current exposure to possible decline in the business performance would be exacerbated by purchase option

Reasoning

Available marks

Maximum
Part (e)
Razzmatazz shareholders' concerns:
- loath to provide suretyships 1
- interest rate too high 1

Views/opinions:
- theatres are special purpose buildings therefore higher financing risk 1
- company has limited assets available for security therefore, banks reasonably looking to individual shareholders for collateral 1
- is there any distinction between individuals and company? 1
- theatre business may be correctly perceived as high risk because of declining audiences & high fixed costs 1

I would strongly advise shareholders not to provide suretyships but rather to pledge their shares in the company. 1
- suretyships are onerous obligations 1
- joint & several suretyships are unfair 1

Interest rate not unreasonable given the perceived loan risk 1

Available marks 9

Maximum 6

Part (f)
Factors to be considered:
- how long can interest rate be fixed for? 1
- differential between fixed and floating rate 1
- current yield curve and general views about future interest rates? 1
- any hidden fees and costs associated with fixed rate? 1
- historic interest rate trends 1
- sensitivity and materiality of interest rate movements 1
- vulnerable to downturn in the economy with high fixed costs 1
- consider interest rate swap with third party 1

Available marks 8

Maximum 6

Part (g)
- No natural hedging opportunity available or ability to pass on increased costs 1
- Order equipment from SA supplier and denominate price in ZAR? 1
- Take out forward cover for specific purchases however, this is a firm obligation to buy US$'s 1
- Currency option may be appropriate given ZAR strength against $ 1
- Pay invoices early if ZAR strengthens any further? 1
- monitor exchange rates and buy forward cover during the course of the exposure when considered appropriate 1

Available marks 6

Maximum 5
Part (b)
Core principles:
- Performance measures should not only comprise financial measures but non-financial measures
- Financial measures tend to encourage short-term behaviour by managers
- Balanced Scorecard requires companies to identify financial and non-financial key performance measures
- Balanced Scorecard provides executives with a high level, comprehensive view of the organisation's performance

  How do customers view us? (Customer view)
  What should we excel at? (Internal business process view)
  How can we continue to grow and improve? (Growth perspective)
  How do our shareholders view us? (Financial view)

- Aim of the Scorecard is to provide a comprehensive framework for translating strategic objectives into performance measures
- Performance measures cannot be viewed in isolation but must be linked to goals/strategies
- Balanced Scorecard should also be a tool to manage strategy in organisations
- Strategy should be linked to specific measures, and mechanisms should be identified to achieve goals/objectives

Possible benefits to Razzmatazz:
- No performance measurement system currently in place therefore introducing a system will be of great benefit
- BS provides non-financial measures
- BS encourages long-term planning and strategic decision making
- BS will provide a link between vision and day-to-day actions

Available 9
Maximum 4

Part (i)
Key issues from a financial perspective:
- Revenue growth
- Cost reduction/control

Gross profit % irrelevant because of high fixed costs incurred by Razzmatazz

Proposed performance measures: Reason

| Attendance levels/capacity utilisation | Critical to sell theatre seats |
| Ticket sales mix | Has major impact on revenue and margins |
| Contribution per patron | High fixed costs therefore contribution NB |
| Increase in overhead costs | Largely fixed in nature, therefore, cost control NB |
| Operating cash flow | Cash is king |

Available marks 10
Maximum 10

Part (j)
Increase revenue
Sell food in addition to beverages
Discount ticket prices to get more feet through the door?
Promote theatre as a means of client entertaining
Increased marketing
Sell advertising in theatre
Sell momentoes, trinkets and items such as CD's

Reduce costs
Increase direct ticket sales as opposed to selling through agent
Negotiate rental linked to revenue?
Offer musicians/artists lower fixed salaries/fees and pay performance bonuses?

Available marks 11
Maximum 8

Presentation marks 6