



## Why I'm Not Buying Cineplex Inc.

### Description

A quick glance at the three-year chart for **Cineplex Inc.** ([TSX: CGX](#)) reveals that investors who were wise enough to purchase shares at the beginning of 2012 would have by today realized an almost 88% appreciation in share price, rising steadily from approximately \$22 per share to its current price of \$40.97 per share.

With analyst consensus for Cineplex currently a "buy" from nine rating firms, investors who missed Cineplex's run up may be tempted to buy, and investors currently holding Cineplex may be considering adding to their positions.

Although Cineplex is an excellent company in many regards (which I will demonstrate), it is showing signs of stretched valuations. For this reason, Cineplex shareholders should be continue holding, but be extremely cautious about buying.

### Why you should continue to hold Cineplex

Cineplex is by far the largest and most successful theater company in Canada, with 162 theaters, and 79% of the Canadian market share. This large market share allows Cineplex to easily drive attendance, and to maintain premium prices, which is reflected in Cineplex's 64.52% gross profit margin for the trailing 12 months. Margins like that are a strong indicator of competitive market position as excess competition typically erodes prices and therefore margins.

In addition, Cineplex has a diversified revenue stream that extends far beyond theater tickets. Cineplex currently offers concessions, premium experiences (such as its costlier Ultra AVX theaters, as well as IMAX and D-box screens) VIP cinemas, gaming, as well as the popular SCENE loyalty program, which is Canada's top loyalty program for movie-goers and allows customers to earn points towards free movies. These products and services, offered under the same roof, interact with each other to increase the amount spent per customer.

Thanks to premium offerings such as UltraAVX, Cineplex has grown its ticket price per patron from \$8.05 in 2008, to \$9.40 today. A similar trend has been observed with concessions per patron, which has grown from \$3.96 in 2008 to \$5.05 today. A strong market share, recession-proof business,

management capable of consistently growing revenue per patron, and plans to add more theaters and service offerings make Cineplex a very strong business worth holding on to.

### **Why not to add to your Cineplex position**

Although Cineplex is a strong company, it is likely overvalued, and due to its dependence on strong movie offerings for earnings, it has suffered the past few quarters. It is difficult to compare Cineplex to its competition to determine its relative value, since Cineplex is the only major publicly traded theater company in Canada. It is however possible to compare Cineplex to the broader market, as well as to its own fundamentals.

Cineplex currently has a price-to-earnings ratio of 34.5, while the S&P/TSX has a P/E ratio of 17.3. It has a price-to-book ratio of 3.5 compared to the S&P/TSX's 2.1, and a price-to-cash flow ratio of 14.3 compared to the S&P/TSX's 9.5.

The fact Cineplex is much more expensive than the average company may mean it is overvalued, but it may also mean Cineplex is an exceptional company with solid growth prospects and is deserving of its high price.

Here is why I don't think this is so. Currently, analysts give Cineplex a long-term growth rate of 15.90%. Comparing this to the company's current P/E ratio of 34.5 gives Cineplex a price/earnings-to-growth (PEG) ratio of 2.16. This is fairly high (studies have shown PEG ratio's over 1 and especially 2 have much lower returns). This suggests that Cineplex is likely trading too high for its current growth rate, and is possibly overvalued.

Cineplex is a great company, and while you should consider holding onto your shares and receiving its 3.60% yield, you should be cautious to buy especially after its three-year run-up.

### **DISCLOSURE:**

#### **CATEGORY**

1. Investing

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