Now Playing: Cineplex Inc. Successfully Navigates a Challenging Environment

Description

Industry-wide box office revenue continues to fall. But yesterday, **Cineplex Inc.** (TSX: CGX) reported fourth-quarter results that demonstrates the strength of this company and management team. While box office revenue decreased 2.9%, food service revenue increased 4.8%, media revenue increased 19.5%, and the “other” segment, which includes gaming, the Cineplex store, screenings, private parties, and more, increased 16.1%.

The box office segment represented 51% of total revenue versus 56% in 2013, food service represented 29.4%, media represented 14%, and “other” represented 4.6%. Adjusted EBITDA margins increased to 18.9% versus 16.8% in the same period last year due to a higher percent of revenue coming from the higher margin food service and media segments.

Diversification strategy continues to pay off

As is evident in the latest results, the company is positioning itself to be more than an exhibitor of movies and plans to leverage its strong brand name in order to do this. Cineplex’s gross margin on box office revenues is 48%, compared to a gross margin of 80% on concession stand revenues, and 80%+ for other revenues, which is mostly media.

Other revenue is expected to be close to 20% of the total by 2016, and long term, the goal is to generate 25-50% of EBITDA from non-Hollywood product. That percentage is currently in the high teens. The company sees the greatest opportunity in digital signage and gaming but is also testing taking its food brands out of the theatre.

Box office challenges

Amazon.com Inc. (NASDAQ: AMZN) has recently joined **Netflix, Inc.** (NASDAQ: NFLX) in entering the movie business, that is, Cineplex’s turf. Amazon recently announced that it will produce and acquire films for theatrical release and early distribution on Amazon Prime Instant Video. Amazon intends to make its movies available on its subscription-based Prime Instant Video streaming service in the U.S. four to eight weeks after the theatrical debuts, versus the current three to four months. The shrinkage of this theatrical window is a concern for Cineplex, but keep in mind that 80-85% of box office revenue is earned in the first four weeks of release.

Over at the Cineplex Store, Cineplex's digital movie site where movie watchers can rent or purchase movies to watch at home, business is progressing at a measured pace. With a newly hired senior vice president, the company is clearly focusing on giving Netflix and now Amazon a hard time. With the Scene It points program as well as bundling products such as the Superticket, management expects to continue to see a steady uptick in results here.

Opportunities

Free cash flow generation has historically been and continues to be strong, and this will fund the company's higher than normal capital expenditure plans in the next few years in order to bring its vision into reality. Management has said that Cineplex would like to "own its guest", and become the go-to source for Canadians' entertainment needs in theatre, at home, and on the go.

The Rec Room: Cineplex recently announced plans to develop this concept, which it calls "Canada's premier social entertainment destination". This complex will include a wide range of entertainment games, a venue offering live entertainment, and a theatre-sized screen for watching the game or other programming. The first one will open in Edmonton and the company sees room for 10 to 15 locations across the country over the next three to four years.

Ultra AVX: Cineplex's offering of "premium" experiences will continue to drive up revenue per box office ticket as well as visits to the theatre. For example, Cineplex's Ultra AVX, with reserved seating and superior sound and picture, is seeing strong interest from moviegoers. These AVX units are the ones that sell out the fastest and management sees room for at least another 10 to 15 of these.

A blockbuster buy?

The stock is not cheap on a P/E basis. However, given the opportunities that lie ahead of the company and its history of solid execution and returns, the valuation appears justified. With its track record of strong dividend increases and successful execution of its strategy, the stock should continue to reward shareholders going forward with more of the same. The current dividend yield is 3.14%.

CATEGORY

1. Investing

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1. Editor's Choice

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2. NASDAQ:NFLX (Netflix, Inc.)
3. TSX:CGX (Cineplex Inc.)

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