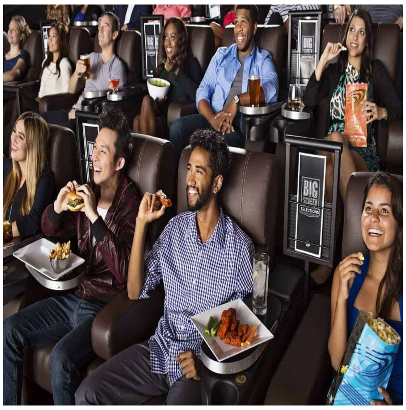

Does Cineplex Inc. Fit in Your Portfolio?

Description

With the advancement of streaming services and the quality of in-home movies, pundits have been prophesying the death of movie theatre companies like **Cineplex Inc.** (TSX:CGX).

And yet, time and again, the company has demonstrated that it is strong, stable, and, most importantly, becoming increasingly diversified. Recognizing that these streaming services and in-home movies could one day start taking bigger bites out of Cineplex's cake, the company has made necessary steps to be a true entertainment company versus just a movie business.

Nevertheless, Hollywood has been doing wonders for the business. *Wonder Woman* had a meteoric opening weekend and should continue to crush it as more people check out the movie. *Guardians of the Galaxy Volume 2* and *Pirates* have both consistently brought people to the theatre.

While those of us who worry about the quality of film might complain, the reality is, Hollywood has a formula that is working really well. Superhero movies, *Star Wars* movies, and other big-ticket productions continue to come out on a regular basis, providing ample opportunity for theatres to get people in the front doors.

And once customers are in the front door, they're spending more money. Food service revenue increased by 1.7% in Q1 to $113.9 million, and total box office revenue per patron increased by 3% to $9.97. So long as the movie line-up stays strong, Cineplex should continue to generate lucrative returns. The problem is that there is a dependency on Hollywood to continue creating new content.

Fortunately, the company has that problem figured out.

Cineplex has invested in eSports business. People can watch other people play competitive video games; however, rather than doing that from the comfort of their homes, they can make it a big event and go to the theatre. Why watch on a small screen when you can watch on a massive screen? This provides sponsorship opportunities and food service revenues.

Then there's its Rec Room project. These are multi-purpose destinations with restaurants, gaming, and other activities. During the day, businesses can have team-building events there, and at night, families can go. I like this project because the revenue is, again, not dependent on Hollywood. In Q1, the two Rec Rooms brought in $2.1 million in food and $2 million in amusement revenues. Three more Rec Rooms will launch in 2017, so this will have a big impact on revenue.

Cineplex’s media and digital arms are another opportunity. I already mentioned the eSports sponsorship revenue, but there are also advertisements that run before movies start. And then there is the digital signage business used in fast-food restaurants. This provides recurring revenue and, although it’s a small piece of the pie, it’s growing.

So, does Cineplex fit in your portfolio?

The answer is, maybe. On one hand, the $1.68-per-year dividend, which was recently increased by 3.7%, is very appealing. On the other hand, this stock is very expensive. And whenever you’re investing in companies that depend on discretionary money, you have to be cautious of the cyclical nature of economies. I think Cineplex is a great business, but with shares trading at such a premium valuation, you need to have faith that the Rec Room and other projects will provide enough revenue to continue growing the company.

CATEGORY

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