4 Reasons Why it May Be Time to Sell Cineplex Inc.

Description

Cineplex Inc. (TSX:CGX) has been a high-dividend market darling for many years as the management team found new ways to innovate in the movie and popcorn business.

Cineplex may be suffering from stalled growth since there are only so many ways you can innovate with such an old-fashioned business model. Shares took a 4.2% plunge Friday as **National Bank of Canada** downgraded the company to sector perform.

Here are three reasons why Cineplex may continue to be a laggard.

First, the management team is struggling to come up with new concepts. VIP cinema, DBOX, and arcades gave Cineplex a nice boost, but it appears there aren't any more answers to continue the company's hot streak of growth its low-growth industry.

You really can't blame the management team for this one. They just set the bar high in the past, and it appears that the company is suffering from a base case of growth stagnation.

Second, we're moving towards a "stay-at-home economy," which is a trend that's probably sticking around for the long term. Many people work from home, are entertained from home, and get food as well as everything else delivered to their homes. There's less incentive to leave the house than there ever has been.

Unless there's a movie that people are dying to watch, they're probably going to stay at home and watch a movie on **Netflix** or enjoy a film on a virtual reality device that simulates the big screen environment that movie theatres offer.

There were only a few must-see movies in the first half of the year, but there appears to be more promising titles coming in the latter half, like *Star Wars: The Last Jedi*, which is pretty much guaranteed to be a solid performer at the box office.

It's movies like these that will incentivize the average person to leave the house to go to a theatre. Without such blockbusters, we could see traffic at Cineplex take a plunge as it becomes even more convenient for everyone to just stay in their homes.

Third, the general public is becoming more health conscious, and Cineplex's popcorn, soda, alcohol, and hot dogs aren't catering to this rising trend. This means health-conscious movie goers will order less, and concession sales will suffer, unless the management team listens to what its customers want.

Does that mean Cineplex will be selling quinoa and kale chips anytime soon? Possibly; I think they should offer such items as they would likely give concession sales a nice boost.

Lastly, the stock currently trades at a 39.34 price-to-earnings multiple, which is quite absurd considering it appears that the growth has faded. Margins and earnings have taken a step back of late, and unfortunately, I don't think this is a temporary bout of underperformance.

Cineplex is running out of growth prospects, and I think long-term headwinds are a reason to be concerned for shareholders, especially with its hefty valuation.

In the end, there will always be great movies that will get us going to a movie theatre, so Cineplex can be seen as a stable stalwart. However, many investors may be disappointed that the company is no longer the same growth king it was a few years ago. I'd avoid the stock because of its overvaluation and long-term headwinds.

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