Can Cineplex Inc.'s Rec Room Give it the Moat it Needs to Survive?

Description

Cineplex Inc. (TSX:CGX) released its second-quarter earnings which, unfortunately, did not inspire investors to buy into the stock. Rather, the stock has plummeted over 10% since the earnings were posted.

Revenue is up, but attendance is down

The latest earnings showed a year-over-year decline in box office attendance of 2%, but that was offset as the revenue per patron was up almost 5%. Year-to-date attendance is down even more; 3.6% fewer people went to the theatres than they did a year ago. This is a concerning trend in an industry that, so far, has been able to survive the online streaming revolution.

It wouldn't be surprising for investors to be a bit hesitant to invest in an industry that has probably seen its best days behind it. People still fill up movie theatres and, for some, there is still the allure of a night at the movies. Just because people can watch movies at home doesn't mean theatres will go out of business; it's similar to how restaurants are in no danger of people deciding to eat in. The one discernible difference is that people need to eat, but watching the latest movie is a leisure and otherwise discretionary expense that is a nice to have.

Discretionary spending

As the economy sees interest rates rise, and many expenses increase as a result, including housing, wallets will start to get tight. When expenses get high, the prospect of going out to watch a movie and spending money on concession may be too rich for some to afford.

Where future growth will come from

The biggest concern going forward is if Cineplex can continue to grow its business and prove that it hasn't peaked or that it isn't already in decline. One way to grow is to find a way to bring attendance numbers up; the other is to increase revenues per attendee, which will offset the lower attendance.

Currently, revenues per attendee are up, but whether or not that trend will continue and, more importantly, whether or not it can offset declining attendance will be key.

Cineplex branching into the restaurant business

The company is working on its Rec Room experience, and that seems to be the main opportunity for it to be able to grow revenues. The problem I see with this is that it's a movie theatre company trying to reinvent itself as a restaurant with games, movies, and other attractions.

First of all, the restaurant industry garners a lot of competition already, and margins can be razor thin. A quick look at some of the reviews for the Rec Room suggest that people are more attracted to the games than the food, and that is not going to bring in big dollars if that trend prevails.

I would also be a bit concerned how a bar is going to coexist in a supposed kid-friendly place, where games and other family-friendly entertainment takes place. The concept is still in early days, but I'm not a believer that it will succeed.

Bottom line

The theatre industry is in the decline; there is no questioning that. It has survived longer than video rental stores because theatres had one main advantage: newer releases. Once theatres lose that advantage, any moat the industry had will be gone, and adding food and video games to the declining business model won't be able to save it.

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djagielski