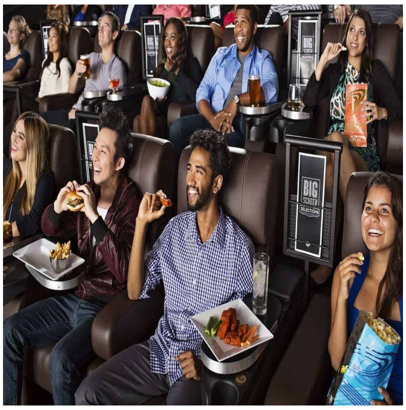

Cineplex Inc.: Time to Pick Up Cheap Shares?

Description

It has been a painful few weeks for **Cineplex Inc.** (TSX:CGX), which released its Q2 2017 results at the beginning of the month. Since then, investors have fled, pushing shares down nearly 20%. But we'll always find that one investor's fear is another investor's opportunity.

The quarterly results were mixed. Box office revenue was $170 million, up 2.4% from Q2 2016, continuing a long pattern of improving box office revenue. However, concerned investors noticed that attendance dropped by 2.2% compared to Q2 2016. Fewer people went to the movies, but they spent 4.8% more than they had a year prior.

I've written often about how Cineplex is highly dependent on Hollywood to deliver amazing movies. Unfortunately, 2017 has not been great for movies. U.S. competitor **AMC Entertainment Holdings Inc.** (NYSE:AMC) blamed its own significant drop in earnings on a multitude of reasons with the primary being "a weaker than anticipated industry box office in the U.S., not expected to strengthen until the fourth quarter of 2017."

Think about it … what movies came out in this quarter that were exciting? *Baywatch*? I love the Rock, but it was a flop. *King Arthur*? I want to see it, but I'm waiting to rent it. Although the amazing *Wonder Woman* came out, unless it is *Star Wars*, one movie can't change a theatre company's outcome.

It was a bad quarter. And that's the inherent risk of the Cineplex business. Although Q4 will be great when the next *Star Wars* comes out, dependence on Hollywood makes Cineplex dangerous.

So, you should dump the shares, right?

Wrong. Cineplex also understands this risk and has been aggressively making changes to its business model to pivot into an entertainment company versus just a theatre company. There's no denying that a significant amount of its money will come from movies, but there are other initiatives that are going to come into play.

The big one that I'm incredibly bullish on is the Rec Room: 60,000-square-foot venues that offer video arcades, restaurants, and bars for people to enjoy themselves. The difference here is that there's no movie drawing them in — the fun draws them in.

In Q2, the Rec Room brought in $2 million in food services revenue and $1.7 million in amusement revenue. This is down a little from Q1, but I expect Q3 to be a big boost because a second Rec Room just opened in June. Over the next few years, this will expand to 10-15 total Rec Rooms. Assuming each one does about $4 million a quarter in revenue, you're looking at anywhere from $40-60 million a quarter.

Cineplex recently launched a joint venture with Topgolf — a similar initiative to the Rec Room, except it's built around golf. As fellow Fool writer Will Ashworth wrote, "Topgolf is the bowling alley of the 21st century, only with better food and drink." According to the Topgolf fact sheet, 26,000 visitors come to a Topgolf destination per day and stay for about two hours. That's a lot of playing, food, and drink.

Ultimately, we're talking about a business that will become less dependent on movies versus other entertainment. But more importantly, we're talking about a business that's going to see a huge boost in its revenue and earnings over the coming years. Despite a rough quarter, we're still in a golden era of highly profitable movies thanks to *Star Wars* and Marvel. Couple the theatre revenue with the growing amusement revenue, and you've got a great business.

So, take advantage of other investors' fears and grab this opportunity. And along the way, you can collect a 4% yield — something I didn't expect to see from Cineplex.

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