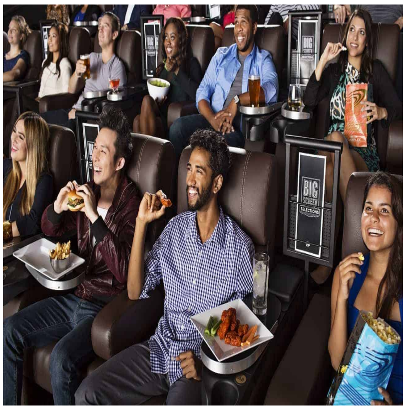

Forget Cineplex Inc. Altogether… It’s Just Not Worth It

Description

In mid-July, I suggested investors forget **Cineplex Inc.** (TSX:CGX) and consider **Cinemark Holdings, Inc.** (NYSE:CNK). Since my article was released, investors who bet on Cineplex would have experienced a 25% loss on their investment, while investors who considered Cinemark would have lost approximately 13%. Both returns don’t look so hot, and looking further into the fundamentals of both companies displays an indication that sector-wide risks pertaining to the cinema business appear to be taking hold around the world.

A yield of nearly 4.5% with a valuation multiple that makes a heck of a lot more sense (but is still vastly overvalued in my opinion) may make Cineplex tempting, but here’s why you just shouldn’t do it…

It appears the catalyst for the drop in these two cinema company’s stock prices had little to do with either company’s very mediocre earnings performance (which is a bit of an understatement), but more to do with the fact that the largest theater chain in the U.S., **AMC Entertainment Holdings Inc.** (NYSE:AMC), reported disastrous earnings in early August, posting losses of more than -US$176 million on attendance numbers which plummeted. The company gave negative forward guidance for the current quarter, in which the chain expects the loss to grow to -US$178.5 million, a far cry from net income just one year ago of $24 million. This earnings announcement sent share prices of all North American theater chains plummeting downward, seemingly without a bottom in sight.

Across the entire U.S. market (and the numbers spill into Canada as well), moviegoers have simply been moving away from in-person entertainment options toward a “Netflix-and-chill” entertainment experience at home. Year-to-date in the U.S. market (data was up to August 1), ticket sales were nearly 5% lower than the previous year, despite consumer spending increasing overall.

The argument that Cineplex is “reinventing” itself with amusement revenues and acquisitions of other mini-golf options, The Rec Room, eSports, or premium movie options such as D-BOX, Ultra AVX or 3D movies is erroneous, in my opinion. The fact remains that more consumers will want to be entertained at home, and leaving the home will continue to become a rarer and rarer occurrence. Whether we are talking about a movie or mini-golf, I find the argument that overspending for acquisitions of bricks-and-mortar entertainment options is a good idea in the midst of online movie options and video game consoles (I hear playing mini golf on the PlayStation is all the rage these days) to be more of a last-ditch effort to save the farm, rather than an investment in the future, which is toward online options and home entertainment, areas Cineplex has lagged behind competitors for a long time.

Bottom line

At this point, enough evidence exists for investors to finally reconsider the cinema space altogether. The cinema business was a great business in the 1960's. In the 1970's and 1980's too. It's just one of those "BlockBuster" type business models that don't see what's coming until it's too late.

Nobody told BlockBuster the future was here. It just arrived, in the same way **Netflix, Inc.** (NASDAQ:NFLX) will eventually destroy (or severely cripple) the cinema industry.

Stay Foolish, my friends.

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