Why This 2017 Dud Could Be the “It” Stock of 2018

Description

The 2017 year was a sub-par for the theatre industry, with few blockbuster movies coming to screens throughout the first three quarters of the year, and many movie theatres reporting negative sales growth numbers. Although this was terrible news for existing shareholders of **Cineplex Inc.** (TSX:CGX), who saw their investments decline from more than $50 per share to $37.50, the other side of the coin is the opportunity now available to those who have been sitting on the sidelines.

After falling to the mid-$30 range, shares of Cineplex have started to find a bottom and potentially even some momentum, as the dividend yield is now a healthy 4.5%, and investors taking the leap are also receiving a piece of a unique asset in the process. In Canada, there is no major competitor on a national scale like Cineplex, which will allow the company the pricing power that is has enjoyed for so long.

To properly evaluate this name, it is essential to understand the lens through which it needs to be viewed. Similar to a pipeline or utility company, which own assets that are extremely long term in nature, the movie theatre business is all about cash flows and not so much about net profit. As long as the company brings in enough cash to sustain and possibly raise the dividend, investors will be handsomely rewarded over time.

Over the past three years, the company has generated positive cash flow from operations (CFO) of $166 million (2016), $230 million (2015), and $180 million (2014). Throughout the first three quarters of fiscal 2017, the CFO fell to an abysmal $35 million.

Over those same periods, dividends (which are paid on a monthly basis) continued to increase on a per-share basis, as total shares outstanding increased only marginally. The dividends paid were $101 million in 2016, which accounted for close to 61% of CFO. For 2015, dividends were $97 million, which was 42% of CFO. In 2014, dividends paid were $93 million, which accounted for close to 52% of CFO.

For 2017, things are not nearly as good. With CFO of only $35 million, and dividends that have taken $78.5 million from the coffers, the company has a major challenge to deal with. Although the fourth quarter is expected to be one of the busiest, the problem faced by the company may just be that of capacity. There are only so many seats in each movie theatre that can be sold at a fixed price.

Although hit films such as *Jumanji* and *Star Wars* will come to the big screens over the next month, the catalyst (for shareholders) will only come if there are multiple blockbusters that enter theatres throughout the year.

With what is expected to be a strong lineup in 2018, shareholders may only be starting out on the gravy train with the dividend — capital appreciation may also follow in a big way.

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