This Canadian Monopoly Is a Falling Knife That's Plunged ~40% Peak to Trough

Description

After **Cineplex Inc.** (TSX:CGX) plunged ~42% from its all-time high, you would think that the stock would now be fairly valued or even cheap. That's still not the case, as shares appear to in correction mode; it appears that the general public believes that Cineplex is no longer a growth gem it used to be and is a low-growth stalwart with a high dividend yield.

Last year, I'd warned investors that Cineplex would likely have a nasty tumble, since the valuations made absolutely no sense given that the rise of the "stay-at-home economy" caused video streaming services such as **Netflix Inc.** (NASDAQ:NFLX) to have a better lineup of content that'd likely stop heavily indebted Canadians from going to the theatre and forking out a great deal at the concession stand to go with a sub-par movie that's probably no better than a direct-to-stream movie that's available on Netflix.

Cineplex used to be the go-to place for a date night, but now that we're in the modern age, and streaming is the way to go, many folks — millennials, in particular — have simply opted to invite a date over to watch Netflix.

That's a tonne of lost business for Cineplex, which essentially has a monopoly over Canada's movie theatres. With a virtual monopoly, you'd think the company would be better able to weather such a downturn, but you'd be wrong. I'd sensed a perfect storm brewing well before Cineplex announced its absolutely abysmal numbers, which sent shares tumbling into the abyss.

Even after the tumble, and what appears to be two dead-cat bounces, Cineplex still trades at a hefty growth multiple. At a trailing 30.17 price-to-earnings multiple, there's still plenty of downside that remains, and given what appears to be a continued Hollywood movie drought, substantial downside remains if Cineplex is to be valued as a slow-growth stalwart. Sure, Cineplex is diversifying away to become a general entertainment company, but this shift will take years and won't provide short-term investors with the relief they're looking for.

Sadly, not even the beloved *Star Wars* franchise is able to save Cineplex now, so I'd only recommend buying shares of Cineplex if you intend to average down, as shares still stand to be punished. Although

Cineplex is a virtual monopoly in Canada, it doesn't have pricing power, as we've clearly seen. I expect price cuts to movie tickets, concession stand items, or even special promos to drive traffic back to its theatres. That's going to hurt margins, but it looks to be the only option at this point — at least in the medium term. Canadians are already heavily indebted, so Cineplex really needs to "make 'em an offer they can't refuse," because cyclical goods are probably the last thing that Canadians should be spending money on.

Bottom line

I'm a fan of the company's long-term goals, but let's be real. These goals won't substantially change the business model over the course of a single year, so I'd recommend the average investor to look elsewhere, unless they've got experience with catching falling knives.

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