Don’t Be Tricked by Cineplex Inc.’s Recent Earnings Release

Description

Any time a company’s top and bottom lines show improvement year over year, it can be easy to jump to the initial conclusion that all is well at the underlying business. What investors want is fundamental growth, and on the surface, **Cineplex Inc.** (TSX:CGX) appears to have done a good job of providing that growth to investors.

Looking at the company’s recent earnings report can be misleading; investors who refuse to dive any deeper than the aggregate reported numbers will miss some very disturbing trends, which should be made apparent to any investor considering an investment in the beaten-up cinema chain any time soon.

I’m going to highlight a few of the issues I have with the recent earnings release, and why I believe Friday’s increase of more than 6% over Thursday’s close represents an excellent short opportunity for investors looking at overvalued firms on the TSX today.

Attendance declines are only going to continue

While there is no wide-spread term that has been coined as of yet to describe the mass exodus of moviegoers from the cinema to their living rooms, this trend is real, and it’s only likely to pick up steam moving forward. Statistics have shown that 2017 was the worst year on record for cinemas across the continent since the early 1990s — a fact which Cineplex certainly does not want to highlight in its annual release, and a fact which many investors seem to ignore.

The growth investors have priced in to **Netflix Inc.’s** share price has to come from somewhere, and with 4K, high-definition, virtual and augmented reality, and other technologies set to make a moviegoer’s in-home experience even better, the impetus for such a consumer to go and spend $15 or $20 on a movie ticket at a Cineplex location is significantly reduced.

Instead of focusing on the declines which have begun to impact Cineplex’s free cash flow generation abilities, investors often focus on the ability of the firm to raise prices. Here’s why I believe this is a dangerous attitude to perpetuate.

Price increases are an unsustainable way to improve revenue and profit long term

Companies operating in highly competitive industries such as the entertainment business will note that while some slack exists with respect to the prices consumers are willing to pay for the entertainment they consume, the reality remains that the value proposition of cinemas is beginning to lose out to the growing value being provided by streaming services currently.

The cord-cutting phenomenon currently underway in the cable world has hit the valuation of entertainment firms such as **Walt Disney Co.** like a sledge hammer in recent quarters; if one of the most innovative entertainment companies is feeling the pinch of declining consumer appetite for traditional entertainment experiences, I would question why Cineplex should be treated any differently.

Stay Foolish, my friends.

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