Why Now Is the Time to Sell That Cineplex Inc. (TSX:CGX) Stock

Description

The volatility that has permeated financial markets of late is truly incredible; some firms have seen valuations shoot through the roof, while others have continued to be hampered by “pesky” shorts or those who do not believe a long-term growth story is credible.

At this point in the current bull market, which has now officially become the longest in history, I really see most valuation increases as evidence of investor belief in the growth story companies can tell investors. Full stop.

Tax reform in the U.S., continued economic growth in North America, and a relatively relaxed lending environment have led us to nearly 10 years of unobstructed valuation increases. Investors simply believe that tomorrow will be better than today, and until the narrative changes, buying “story” stocks such as cannabis producers and artificial intelligence players is the hot thing to do.

After all, these companies are the ones that have produced incredible results.

One Canadian company that aptly represents the current sentiment of the market is **Cineplex Inc.** (TSX:CGX) for a couple of reasons.

Cineplex’s stock price obviously rises and falls with the slate of movies released. Fellow Fool contributors continue to talk about how the slate of movies that have come out, or are scheduled to be released, will affect the company’s stock price. This is clearly a short-sighted view that long-term investors should ignore; however, the valuation swings the company has seen provide opportunities to buy and sell the company’s stock. On the most recent uptick due to higher-than-expected earnings, I would argue that now is the time to sell the stock on good news. The long-term story isn’t great for this cinema-heavy organization.

Cineplex’s valuation multiple has dropped dramatically in recent quarters despite revenue remaining relatively in line with year-over-year numbers, reflecting the position of many long-term investors such as myself who believe any growth in the future is likely to be less profitable, or more expensive to acquire. I would argue vehemently that the earnings quality Cineplex has provided investors has deteriorated significantly due to a macro shift in the way consumers consume entertainment. In that regard, I do not think that Cineplex is in and of itself a poorly run outfit, but rather that the cinema industry as a whole is undergoing a fundamental shift and Cineplex has not come along for the ride.

Ignoring the short-term noise, and thinking about the long-term trend of how consumers will consume entertainment is fundamental to deciding whether Cineplex belongs in your portfolio. If you are a day trader looking to buy the dips and sell the peaks, then determining whether now is the proper time to sell is a judgement call based on your technical analysis. I don't do technical analysis, just long-term fundamental analysis, and on that basis, I'm out.

Stay Foolish, my friends.

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