Why 2019 May Be the Worst Year Yet for Cineplex Inc. (TSX:CGX)

Description

Here we go again!

Cineplex (TSX:CGX) stock nosedived 21% in a single day following the release of its brutal third-quarter earnings results, which saw adjusted EBITDA numbers miss the mark of analysts by a country mile ($53.4 million vs. the $64.2 million consensus).

While the Cineplex's more promising long-term diversification strategy makes its stock an intriguing turnaround candidate, I've warned investors that it would take several years before the company would have meaningfully diluted its exposure to its abysmal box office segment. And in the meantime, the company would continue to stop the bleeding from its box office segment.

Will Ashworth, my nemesis here at the Motley Fool Canada, believes that Cineplex is suffering from a temporary bout of lousy content. There's no question that Cineplex's drought at the box office is preventing the company from getting butts in the seats of theatres, but where I believe Ashworth is wrong is with regards to the "content drought" being temporary.

I not only think the theatrical "content drought" is permanent, but I think the bleeding at the box office will get much worse before it gets any better, and, unfortunately, it'll be entirely out of the hands of management, as Cineplex just found itself on the wrong side of a secular trend.

Cineplex will be a casualty of the content arms race

Apple and **Disney** are breaking into the video-streaming world next year, and that's going to give movie goers even less of a reason to catch a theatrical release on the big screen.

To make matters worse, Apple is making its original content completely free of charge for its device users. With big names like Stephen Spielberg and M. Night Shyamalan on Apple's streaming bandwagon, I think we're about to enter an era where it no longer makes economical sense for movie producers (or content consumers) to throw their money at theatrically released productions.

Established film producers are beginning to partner up with streamers that have deep enough pockets to back them, rather than testing their luck at the box office, which is no longer a guarantee of success.

Consider what we've witnessed over the past few weeks: Apple partnered up with the A24, the independent American film producer behind the Oscar-winning production *Moonlight*, and **Netflix** struck a multi-film deal of its own with Viacom.

Dividend cut on the horizon?

I think this is just the beginning of a fierce battle for content producers, and as the streaming market becomes that much crowded next year, Cineplex will probably have tumbleweeds rolling around its once lively theatres. Sadly, the company may have no choice but to cut its dividend next year, as it doubles down on its diversification efforts — the only thing that will allow Cineplex stock to see the light of day again.

The non-box-office segment is continuing to pick up traction (eSports and Rec Room are major bright spots), but in the meantime, it's going to be the box office segment that'll dictate the trajectory of the stock, at least over the next three years.

Foolish takeaway

At 22.6 times trailing earnings, I still wouldn't touch the stock with a barge pole at this juncture because 2019, I believe, is the year that video streaming will really start to take off with Disney+ and "Apple Stream" ready to hit the video-streaming market.

Cineplex investors have the right to be worried, and I don't think the 6.2% dividend yield is worth biting on at this juncture, even if management decides to keep it intact in spite of the mounting troubles at the box office.

I think there's a lot more downside ahead, and if you're looking to play the company's transformation into a diversified entertainment company, I'd either wait for a more attractive entry point or a spin-off of the "amusements and entertainment" business and invest in that.

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