Is Disney+ About to Ruin Cineplex (TSX:CGX)?

Description

It has not been a good couple of years to be in the movie theatre business.

Despite some very successful movies coming out since 2017 — including the highest-grossing film of all time, *Avengers: Endgame* — movie theatres have been plagued with declining attendance. For instance, **Cineplex** (TSX:CGX), Canada's largest chain of movie theatres with close to an 80% market share, told investors in its most recent quarter that theatre attendance fell 1.7%. Year-to-date results are even worse, with theatre attendance falling 8.8% in the first half of 2019.

Now that **Walt Disney** (NYSE:DIS) has announced its widely anticipated Disney+ streaming service is on its way to Canada in November, Cineplex bears are more convinced than ever that the movie theatre business is in terminal decline. After all, who wants to spend $50 for a couple to go to the movies and get snacks when you can subscribe to Disney+ and **Netflix** for a whole month for just half that much?

But at the same time, I'm not sure this marks the end of Cineplex or the movie theatre industry, either. Let's take a closer look at this issue from both sides.

Theatres are doomed

It isn't just increased competition from streaming services that is hurting the movie theatre business. Naysayers argue it's not really that good of a business to begin with.

Cineplex has invested millions in making the movie-going experience more enjoyable. It has spent money on bigger screens, digital projectors, reclining seats, and just making its theatres nicer in general. Bears are worried more cash will have to be spent in an attempt to get more people in the door.

Who knows what the next generation of improvements will be to movie theatres? Operators like Cineplex are testing new concepts as we speak. But one thing is for certain — movie theatres have high capital expenditures. This will lead to an indebted balance sheet, which is never a good thing to have when your core business is declining.

There are so many entertainment options these days, it's little wonder folks aren't going to the movies any longer. Streaming services are cheap, and big TVs have made watching a movie on Netflix almost as enjoyable as going out to the movies. Other entertainment options like video games and board games offer good value on a per-use basis, too.

And then there's Disney+, which will have a catalog of all Disney's old movies. Why see the current blockbuster in theatres when you can just wait a few months and watch it in the comfort of your own home? It's a budget-friendly choice, especially for families with kids.

The bull case

Cineplex isn't quite doomed. The company still has a few things going for it.

First off, it has been successful raising prices on both movie tickets and concession food. Average concession spending per patron was up nearly 7% on a year-over-year basis in the most recent quarter. This translated into increased revenue from theatres, despite a drop in attendance.

Cineplex is also working hard on diversification plans, investing in various location-based entertainment options (like The Rec Room and TopGolf), its media division, and owning a video game arcade distribution company.

All of these growth avenues have paid off. In the company's most recent quarter, the top line increased by more than 7%. Adjusted free cash flow per share also increased 13%.

Finally, some commentators have said Cineplex's generous 7.4% yield is going to be cut. I don't see it happening anytime soon. The company gave its dividend a major vote of confidence earlier this year by raising the payout for ninth consecutive year. The payout ratio is just 64% of trailing adjusted free cash flow.

The bottom line

There's no doubt Disney+ will impact the movie theatre business, especially in the short term. People only have so many entertainment hours.

But over the long term, I'm confident Cineplex will be fine. Management is doing a nice job investing in other forms of entertainment, and existing theatres are still delivering plenty of free cash flow. I just don't believe the end of this company is near.

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