Theatres Are Dead: Can We Please Stop Investing in Companies Like Cineplex (TSX:CGX)?

Description

In 10 years, I believe large movie theatre chains will have gone the way of the Do-Do, and investing in such an enterprise would seem as foreign as investing in disposable cameras, CD players, or cassette tapes.

As with other technological advances which that reshaped the medium in which we enjoy entertainment, folks just aren't doing the "dinner-and-a-movie" thing en masse anymore. That said, hardcore investors in these spaces still bang their drums that these businesses can be profitable over the long term. Here's why they're wrong.

The business model has changed

The movie theatre sector has undergone serious consolidation in recent decades, and for good reason. Obtaining movie rights is extremely costly, requiring a business model that relies on scale — having enough patrons come through your door to buy popcorn in hopes that concession sales will offset the extremely slim, or sometimes negative, operating margin which is the reality for many films (i.e., ticket sales are not enough to cover the operating costs of a theatre).

When attendance drops, it's a really big issue for companies like **Cineplex Inc.** (TSX:CGX), something many hard-core investors and pundits brush off with typical inane responses to serious skepticism like "the company had a one-off quarter," "the movie slate was terrible," or my personal favourite, "ticket price increases will offset lower attendance."

The economics don't make sense anymore

The economics of the entire industry doesn't make sense past a certain point – when too few moviegoers come through the doors on a consistent enough basis, either companies like Cineplex will demand concessions (no pun intended) from Hollywood (very unlikely to materialize), or continue to raise prices, furthering the downward spiral in attendance to the point that very few people will go to the movies anymore because they can't afford it.

Heck, for the price of two AVX tickets and a few snacks, one could get a pretty fancy dinner and a movie at home — an increasingly attractive option due to online streaming platforms that Cineplex and other movie chains seem to have no answer for.

The fundamentals aren't great

Cineplex has a dividend yield of 7.9%, which seems pretty great on the surface for investors seeking yield. Many investors have bought into companies like Cineplex due to the fact that these outfits have continued to raise dividends for some time, a reality I don't see as realistic over the long run given the extremely tight net margin of 3% made possible only because of ticket price increases in recent years.

When the company is forced to halt dividend increases, cut or eliminate its dividend, investors are bound to get hurt.

Cineplex is still priced around 30 times earnings, a ratio which makes no sense to me given my long-term outlook for this company. The company has a massive debt load of more than $2 billion, a current ratio of 0.44, and a cash flow statement that says all that needs to be said about the feasibility of returning cash to shareholders in any meaningful way over the long-term.

Stay Foolish, my friends.

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