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12/16/2019

CINEPLEX (CGX.TO)

Business Model

Cineplex Inc. is a diversified media company that operates chains of movie theaters. The company has three business segments: Film Entertainment and Content, Media and Amusement and Leisure. The Film Entertainment and Content reporting segment includes all direct and ancillary revenues from theatre attendance. The Media reporting segment is comprised of the aggregation of two operating segments, cinema media and digital place-based media. The Amusement and Leisure reporting segment is comprised of the aggregation of three operating segments, amusement solutions, location-based entertainment and eSports. Film Entertainment and Content segment generates most of the revenue.

The Company in a Nutshell

- Cineplex's main strength is the fact it has the lion share of the movie theatres in Canada.
- CGX is growing its revenue through premium experience (VIP) and food and drinks.
- Cineplex is improving its services toward more media and gaming offering through The Rec Room.

Investment Thesis

As Cineplex evolved its business model toward more premium services, it enjoys not only a huge market share, but is able to generate interesting margins. Cineplex is also in line with its time with a successful online streaming platform. Finally, CGX is gradually building a serious bond with its clients through the SCENE loyalty program. From 600,000 members in 2006, SCENE now counts over 10 million members. CGX keeps investing in its VIP and Rec Room projects for additional diversification. While the stock price is very low, CGX reassured us by increasing their dividend in 2019. Keep in mind this remains a risky pick.

VALUATION

Dividend Growth Rate Years 1-10: 2% **Terminal Dividend Growth Rate:** 2%

	Discount Rate (Horizontal)		
Margin of Safety	9.00%	10.00%	11.00%
20% Premium	$31.47	$27.54	$24.48
10% Premium	$28.85	$25.25	$22.44
Intrinsic Value	$26.23	$22.95	$20.40
10% Discount	$23.61	$20.66	$18.36
20% Discount	$20.98	$18.36	$16.32

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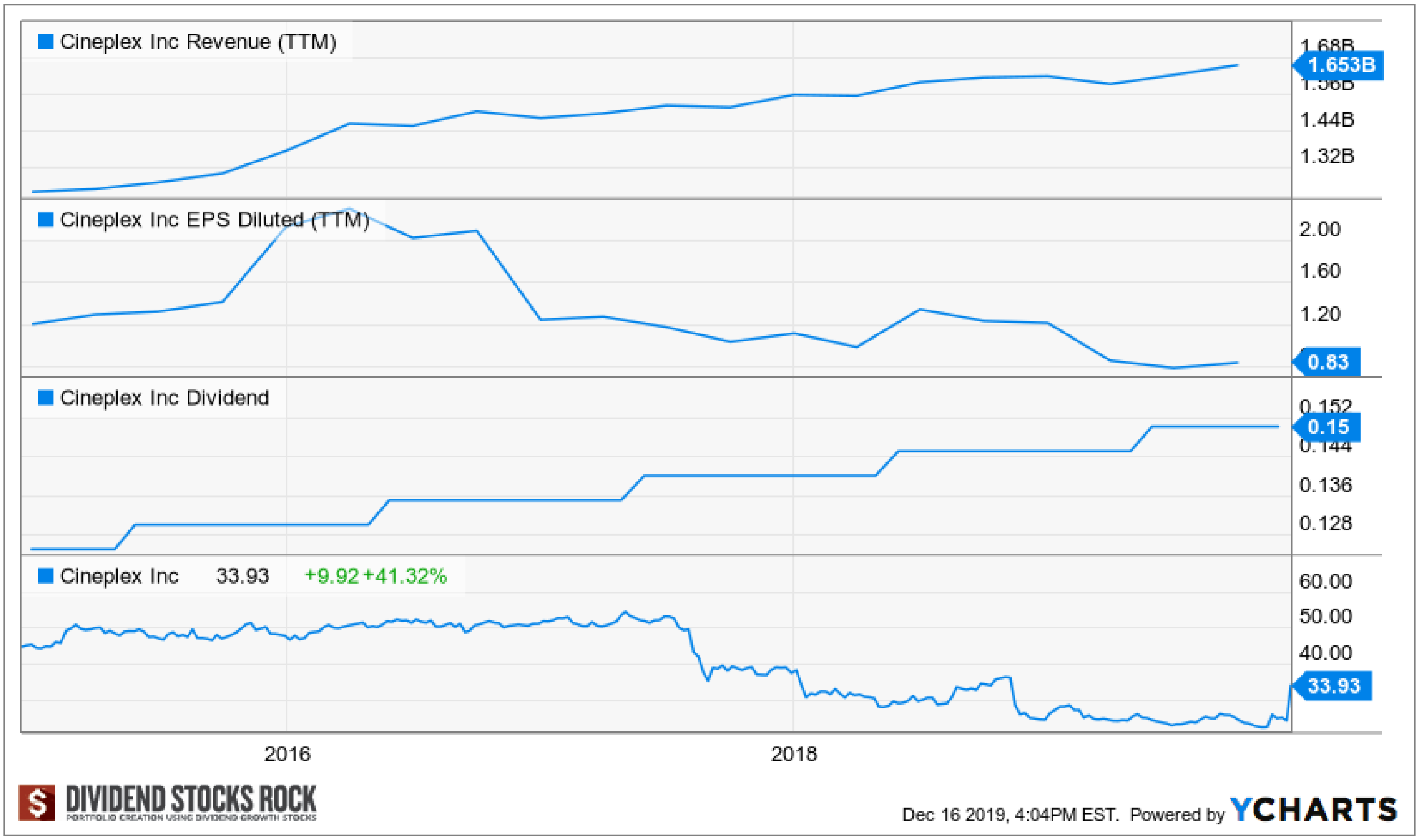

Potential Risks

A poor movie line-up, minimum wages going up to $15/hr and difficulties to convince the market its business model will thrive in the future; this is what is happening recently around Cineplex. The company invested massively to diversify its business model pushing the payout ratio over 100%. We have then reduced our dividend safety score (Nov 2018) to “2”. The company showed improvement in 2019, and the stock started to recover. This is the type of play that could be highly profitable but keep a close eye on it.

Dividend Growth Perspective

CGX has the advantage of paying a monthly dividend of over 7%, which is great for income seeking investors. Management remains cautious about its payout, and we have reduced our dividend growth perspective accordingly (2%). A strong leadership presence and steady income should be enough to reward shareholders. The dividend increased in 2019 is a good point, but it doesn’t mean CGX is out of trouble either.