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Cinema Stocks Have Fallen

Once a year we update a little spreadsheet valuation tool for cinema stocks published on our website (just follow the link from the home page).

A couple of years ago we were marvelling at the valuations it revealed, running up to around 15 times EBITDA or more. Current valuations are more modest, or realistic depending on your view

To some extent this has been obscured by the wave of deals which has swept the sector: AMC's embrace of Odeon and Nordic Cinema Group, Kinepolis' capture of Landmark Cinemas and, putting both in the shade, Cineworld's acquisition of Regal.

These deals have also made calculating valuations more difficult or even impossible. For example, while it is probably possible to work out an approximation of pro forma EBITDA for Cineworld and Regal, this is not the case with Kinepolis and Landmark, because there are no publicly available accounts for the latter private company.

But there are three companies unaffected by significant acquisitions for which it is possible to compare valuations today and one year ago. First, what's happened to their share prices:

Share Prices May 2017 - May 2018

Cinemark Holdings	-15%
Cineplex	-45%
Major Cineplex	-17%

Out of these companies Cinemark and Major Cineplex can be said to have growth prospects: Cinemark in Latin America, and Major in its native Thailand and other regional markets it has started to enter. The Canadian company Cineplex is in a different situation. It is s not only operating in a largely mature market, it is also facing a new competitor renowned for operational excellence.

So why are share prices falling? It is not falling profits. All these companies had 2017 EBITDA within 3% of figure recorded the previous year.

Instead financial markets are valuing these profits less highly than on the past by placing lower multiples on them.

EV/EBITDA Ratio at May

	2017	2018	% ch
Cinemark	9.6	8.5	-12
Cineplex	15.4	10.0	-35
Major	17.8	15.4	-13

Why the decline in valuations?

In the short term currently capex at cinema chains is high due to investment in meeting customer expectations of comfort, for example by installing leather recliners, and due to technological advances. Digitisation has been followed by all sorts of innovations in sound and projection: giant screens, motion seating, lasers.

All this capex is leaving less left over as free cashflow – to pay dividends, fund share buybacks or otherwise reward shareholders.

It may be that this surge in capex is just cyclical and returns will rise in future but financial markets, rather typically, are not taking the chance.

There may be another reason. In the longer term, the refusal of admissions numbers to rise or sometimes even keep pace in the most developed markets must lead at least some investors to question what the long term future of cinema is going to be. Especially given the changes going on elsewhere in the delivery of all forms of entertainment. But are we really all going to be watching audio-visual entertainment in an atomised way on our phones? Or just atomised in an extra-wide recliner…

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