

Cineplex Inc:

Financial Performance & Financial Statements

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Introduction

Cineplex Inc. is one of Canada's top entertainment companies, and simply, one of Canada's top companies. It is a "top-tier Canadian brand" because Cineplex is selling the customer experience (Cineplex, 2016a). It is not just a movie screening company, the company has established itself into tons of businesses: Film, food services, online and in-store sales, gaming and "leisure" (Cineplex, 2016a). Cineplex's financial performance and financial statements are affected by the six environments: Political / Legal / Regulatory Environment, Economic Environment, Competitive Environment, Technological Environment, Sociocultural Environment and Geographic Environment (Richardson, 2006). Cineplex has had its fair share of progress and downfalls, and each environment acts as performance indicators.

The political, legal, regulatory environment

Cineplex is a great company to study, not only is it a successful Canadian company but its headquarter is located in Toronto, Canada. Therefore, Canadian political and social risks, rules and regulations *will* affect the company.

Political Governance:

Ontario and most of Canada is noticeably pro-business because of its long-lasting interests in trade and trade agreements between Canada and other countries. It has continued to stay this way both in Justin Trudeau's regime and Stephen Harper's regime. The Walmart's, the Cineplex's, both international and Canadian companies are accepted into provinces. Canada and its provinces affect how Cineplex functions because the company is a participator in Toronto Stock Exchange (TSX) and is surveyed under Ontario Securities Commission (OSC). OSC reports any form of rebellion or resistance towards Ontario

legislature to the Ontario Minister of Finance (Ontario Securities Commission (OSC), “Governance”, n.d., para. 1).

Legal Compliance:

OSC and the TSX are linked because the Ontario securities act gives OSC jurisdiction over TSX. For example, OSC will protect Cineplex investors (CGX investors) on Toronto Stock Exchange (Cineplex, 2016a). OSC's main goal is to protect the market's current and potential investors from corrupt companies and to offer a sense of credibility or integrity to honest companies (Ontario Securities Commission (OSC), “Our roles”, n.d., para. 2).

Responsive Regulation:

Illegal practices lead to fines and other strict sanctions such as job loss, abrupt career ban and imprisonment. Since Canada practices federalism, policies and laws differ in every province and territory. Cineplex has locations in ten out of the thirteen provinces in Canada (see Appendix A for exact location distributions in Canada). Like every other large company in Canada, Cineplex has to be aware of different versions and variances of regulations in each province the company resides in. Yet, there are many regulations that do have the same purpose. Regulations towards trade, for example, no matter which province it comes from, the goal is to provide fair and accessible service outside or within a country.

Illegal insider trading is frequently reprimanded by the OSC. “Insider trading, which generally refers to trading on material nonpublic information, is far from generic. Insider trading can be propagated through many different channels and brought about by different market participants” (Aitken, Cumming, & Zhan, 2015). Market participants who use insider trading are given an unfair advantage when undergoing stock exchange. Usually, such market participants have confidential information about a company or companies that allows them to be profitable in stock exchange, while making others worse-off during trade. Some Canadian

businesses have their connections with illegal insider trading and Cineplex has not been left out of these illegal trading cases. In 1998, David Bruce Fingold was accused of practicing illegal insider trade when he sold his shares of Cineplex Odeon on TSX. He avoided losses because of his acquired knowledge of Cineplex's poor financial result in 1998 (OSC, "Proceedings", n.d., para. 1).

Today, insider trading prevention is one of Cineplex's policies for its investors. "This prohibition is necessary to protect the Corporation and its senior management from any charges or liability associated with any actual or perceived insider trading." (Cineplex, "Insider Trading Policy", n.d., Para. 1). This will keep the Company's financial statement from acquiring avoidable costs.

Economic Environment

When examining Cineplex's performance, the economic environment was quite hard on Cineplex between the years 2002-2004 when Cineplex Odeon Cinemas merged with Galaxy Cinemas. During 2003, Cineplex raised their ticket prices across cinemas, however these prices were not consistent. Cineplex used income demographics in order to decide which theatres should be more expensive. For example, the four most expensive ticket priced theatres were all located in Toronto (The Globe and Mail, 2005). The goal was to have the price increase offset the drop in attendance, however it was the increase in concession sales which account for 30% of their revenue which truly offset the loss. There was also an increase in the rental cost for films due to the increasing production costs required to make films as a result of technology and the economy, which caused Cineplex to earn less from each ticket sold. In 2002, Canada experienced an inflation rate of 3.8% that caused the company's general and administrative costs to increase by 10.9% (inflation.eu, 2015). This inflation also affected occupancy expenses by 7.1%. However during 2003 there were

favorable exchange rates which allowed the company to reduce the costs of their management fees. By 2005, Cineplex developed a plan to grow and acquired 34 theatres and let go of 35% of their staff so as not to pay unnecessary increasing wages. Today, Cineplex has been struggling in their second quarter (see Appendix C for chart). Since their second quarterly report, Cineplex has raised their ticket prices by about 50 cents in order to account for the minimum wage increases. However due to their being a weak film product, there is a loss of attendance, which is a problem because it accounts for 70% of revenue and also results in a loss of concession sales which account for the remaining 30% of revenue.

While most companies can be greatly affected by changes in the economy, Cineplex is relatively resistant to a difficult economic environment due to the nature of their business. Over the past 25 years, there has not been a significant drop in attendance at the movies due to the economy (Cineplex, 2016), while in fact the opposite can be said. During the great recession that occurred between 2007 and 2011, Cineplex experienced record breaking financial growth for their company. In 2007 when the recession started, Cineplex saw a total revenue increase of 8.8% according to their annual statement. Cineplex attributes this increase in revenue due to a strong film product that was being released that year, however it is more likely that their pricing programs they released throughout the year to make movies more affordable were able to provide an affordable escapism from the recession. In 2008, Cineplex saw its largest growth at the time right in the midst of the great recession. In 2008, their net income grew by 30.6% to \$34.6 million. What made this year so special was following what they found in 2007, the fact that people use movies as a way to escape from the reality of the recession because it's affordable. By providing consistent promotions to their concession stand, people who were trying to save money were more enticed to buy something which rose their sales by 7%. Cineplex also released their SCENE program to

reward people with free movies which increased the amount of guests in the theatres that year by 3.8%. Couple these things with a strong film product, and Cineplex was able to capitalize on the market which at the time was looking for affordable entertainment. During 2009, Cineplex used the same approach as 2008 and refined their SCENE program and made even more enticing product offerings than the year before. They also applied these deals to the new 3D theatres which increased the overall attendance by 10.2% which was record breaking for the company, and their concession sales grew by 14.5% due to this increase in attendance. Overall in 2009, their net income increased by 84.3% which was another record-breaking high even during a recession. 2010 was more of the same with a net income increase of 17.8%. However as the recession began to end in 2011, a noticeable decrease in attendance of 4.2% happened at their theatres. This was slightly offset by an increase in concession sales per person and higher revenue with media, games, and other categories but overall there was less revenue in 2011 than in 2010 by about 0.8%. Since 2011, Cineplex has been increasing their revenue each year through expansion with the money they built up during the recession.

Competitive Environment

Cineplex Inc. represents a lifestyle, an experience. Companies like Walmart and Dollarama are successful minimalist companies. However, Cineplex is not a cheap movie screening entity like Rainbow cinemas at Woodbine, which has a great \$5 movie deal on Tuesdays. Cineplex's strategy is to multiply (occupy space) and add revolutionary infrastructure (cinematic tech trends) as fast as industrially possible (Cineplex, 2016a). The company makes its customers link quality with expense, good quality justifies the expense as worthy. Cinematic technology continues to grow: For example, D-Box has been increasing in popularity in Cineplex locations (Cineplex, 2016b). D-Box offers motion seating experience

that is synchronized with effects and sounds from movies (see Appendix B for exact breakdown of current cinematic technologies).

Cineplex is situated in a highly competitive environment with the emergence of new digital technologies and the abundance of competing movie theatres, which is why they decided to remove their biggest competition in 2005. In early 2005, Cineplex was Canada's second largest film exhibitor, with Famous Players being the first. Later in 2005, Cineplex decided to buy Famous Players, their main competitor for about \$500 million. This created problems with the Canadian Competition Bureau who felt that there would be a substantial loss of competition if the two companies merged (Competition Bureau, 2005). Negotiations took place and Cineplex eventually had to sell 34 theatres with an annual box revenue of about \$100 million. Overall however, this merger allowed Cineplex to control 64% of Canada's box office revenue, making it the largest film exhibitor in Canada by a substantial amount.

Sociocultural Environment

A company that is located in Canada automatically has to deal with integrated societies and cultures, and therefore it deals with integrated markets as well. Although Canadian culture represents the Native Americans, the arrival of the French and English, the maple leaf, the maple syrup, hockey and more, Canada also represents multiculturalism to many people. In Canada, people are not just Canadians, they also might be a Chinese-Canadian, African-Canadian, European-Canadian or other classifications.

Differing cultures and subcultures can cause cultural conflict because certain people and groups can be misrepresented.

Analysis of a Cineplex Ad

On December 15th, 2015, "Lily and the Snowman", a Cineplex christmas ad was posted on their YouTube site (cineplexmovies, 2015). This Canadian ad has an estimate of 9 million views on youtube (2015). Why is it so appealing? The ad shows Lily's relationships with the snowman. People see a shift in the dynamic duo's relationship. Lily forgets the snowman during her teens but remembers him one day, as an adult. Lily and her daughter play with the Snowman, starting the relationship again,

The ad celebrates the vibrancy of the Canadian snow. The ad has the idea of change and preservation, appeasing both the traditional and modern Canadians.

The sociocultural environment help Cineplex understand the social and cultural stance in its Canadian locations. This prevents the company from making ignorant mistakes such as not understanding what a certain culture can and cannot accept. Mistakes affect financial statements.

Geographic Environment

The geographic environment plays a key role in the attendance at Cineplex theatres. Areas with a higher population density and higher income typically can get away with higher ticket prices. This is why Cineplex tends to place theatres in large cities. One of the key elements which lead to the merger between Famous Players and Cineplex was the location of the Famous Players theatres. Famous Players had theatres located in major metropolitan areas and mid-sized markets such as Toronto, Vancouver, Ottawa, etc. These geographic areas are taken into account when considering the overall return for a new theatre. According to Cineplex's 2015 annual report, the majority of Cineplex's theatres are subject to long-term leases, which means they must be extra careful when determining the geographic area for a

new theatre. Areas with a higher population tend to have higher attendance due to the larger market and also make more money per ticket.

A particular problem for movie theatres is trying to get business during the summer months in Canada when the weather is nice. During these times, most people would rather be outside than sitting in a dark theatre. When bad weather hits, most Canadians prefer to stay indoors and wait out the storm rather than heading to the nearest movie theatre. This is why Cineplex released a campaign near the end of their second quarterly report in 2016 called "Weather or Not" (Cineplex, 2016c). This campaign kicked off in Wasaga Beach, Montreal, Vancouver, and Halifax where Cineplex gave away free towels that looked like movie tickets and were also redeemable for a free movie. The purpose of this campaign was to capitalize on their survey findings which found that 30% of Canadians do not have a backup plan if their summer activities are cancelled by weather (Cineplex, 2016c). By providing people with free movies, they would be more likely to go to a Cineplex theatre during bad weather instead of staying home, which would then increase the odds that they would purchase something at the concession stand. Overall, Cineplex's focus on the geographic environment is largely oriented around the weather and the population density around their theatres.

Technological environment

In the 2012 annual report Cineplex stated that their mission is to "passionately deliver an exceptional entertainment experience." And as a part of their strategy to achieve their goal they plan to develop and improve existing infrastructure" (Cineplex, 2012) With this in mind it is important to note that In a company like Cineplex the technological environment plays a very important role in the performance of the company. Cineplex is a company where most of its revenue is based on content that is produced for the media which is often accompanied with

the use of advanced technological infrastructure. It is pertinent to add that this infrastructure can be costly and may include both implicit and explicit costs. According to the 2011, annual report Cineplex invested more than a year of both time and money on their premium products and offerings such as 3D, UltraAVX, D-box and IMAX. These products vastly differed from the regular products or theatres because they required a bigger theatre with larger screens, installation of 3D screens, movable D-box seats. These premium products lead to an increase in revenue which accounted for 29.4% of box office revenue. In other words, it helped to offset losses in that year. The success from the premium products encouraged the company to engage in more differential pricing of theatres and reserved seating (Cineplex, 2011)

Cineplex also made strategic acquisitions to increase media revenue. An example of one of these acquisitions was the merger between Cineplex and EK3 technologies inc London Ontario. According to the financial post Posadzki (2013) stated that Cineplex acquired the company in order to benefit from Ek3's advertising revenue. The deal required Ek3 to sell 97% of their shares to Cineplex. As a result, In Cineplex theatres they are able to show advertisements before the start of a movie. Cineplex orchestrated this move in order to penetrate new emerging markets such as digital display signs and commercial markets as a response to the growing demand for advertisement campaigns in the economy (Posadzki, 2013).

In addition, the 2013 annual report stated that EK3 was renamed CDN, in the third quarter. CDN designs, installs, manages and consults on some of the largest digital merchandising networks in North America, with networks viewed by more than 1.8 billion shoppers annually. CDN contributed \$10.9 million to media revenues in 2013. (Cineplex, 2013)

Secondly, In order to the pursue innovation and to meet society's technological needs Cineplex developed better ways of being more accessible. Cineplex expanded their digital commerce by creating mobile apps and websites for their stores where consumers can stream movies live with extremely good quality. The Cineplex 2013 annual report showed about a 7% increase in visits per person and a total of 3% increase in the amount of visits during the year. These visits include to both the websites and the use of the app during the year and also accounts for 11million in app downloads in the same year (cineplex, 2013)

In the first quarter of 2016 there is an upward progression of the use of Cineplex's digital commerce platforms. The annual report recorded an increase in the amount of independent visits by 48%, total of visits by 30% and an increase in the number of downloads during this year. The report also included an increase in operating expenses such as media change, CSI change, Amusement gaming and leisure when compared to previous years. (Cineplex, 2016)

Furthermore, it is pertinent to add that Cineplex may be experiencing positive growth in the technological environment in recent times. However, they may have to implement more cost effective approaches in order not to acquire extreme loss in the future that may result in a major setback for the company. Based on the report from 2011-2016(q1) it can be observed that the technological environment has a strong influence on the strategies the company implements to achieve their mission because of it competitive and fast growing nature.

Conclusion

Cineplex has proven to be one of the major digital advertising companies in Canada. In the early 2000's - 2016 semi annual quarter, cineplex's financial statements registered that the company has undergone numerous changes and some of these changes are being

influenced by environmental factors. In 2016(q2) the company experienced a decrease in box office revenue when compared to the first quarter in 2016 and 2015 second quarter, however total revenue for both quarters in 2016 increased by 12.8% when compared to 2015 annual report.(Cineplex, 2016(q2)) In the light of that, the company (2016) has also successfully completed its vertical integration as a means to increase diversity. This strategy was implemented as a means to move the company beyond providing entertainment through films by strategically acquiring stages of its production. (Cineplex, 2016(q2))As a result of this acquisition the company can now produce efficiently and at a reduced cost. Following the trends from Cineplex's financial reports ranging from 2003-2016, we believe that over the next year, Cineplex will continue to see growth in their revenue due to an increase in locations as well as future films such as Star Wars: Rogue One, Wonder Woman, Justice League, and Guardians of the Galaxy Vol 2, which will increase overall attendance in 2017 due to a strong film product.

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Appendix A

Cineplex locations throughout Canada, based on June 30th, 2016 records

Cineplex							
Locations and screens at June 30, 2016							
Province	Locations	Screens	3D Screens	UltraAVX	IMAX Screens (i)	VIP Auditoriums	D-BOX Locations
Ontario	67	721	344	36	12	35	29
Quebec	20	250	98	10	3	4	6
British Columbia	24	226	116	15	3	11	7
Alberta	17	193	97	16	2	3	11
Nova Scotia	13	92	44	1	1	—	2
Saskatchewan	6	54	28	2	—	3	2
Manitoba	5	49	26	1	1	3	2
New Brunswick	5	41	20	1	—	—	1
Newfoundland & Labrador	3	20	9	1	1	—	1
Prince Edward Island	2	13	6	—	—	—	1
TOTALS	162	1,659	788	83	23	59	62
Percentage of screens			47%	5%	1%	4%	4%
(i) All IMAX screens are 3D enabled. Total 3D screens including IMAX screens is 811 screens or 49% of the circuit.							

Appendix B

Cineplex's Cinematic Technologies, based on June 30th, 2016 records

Cineplex - Theatres, screens and premium offerings in the last eight quarters								
	2016		2015				2014	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Theatres	162	163	162	162	162	161	161	161
Screens	1,659	1,666	1,655	1,652	1,652	1,648	1,639	1,639
3D Screens	788	790	783	781	781	778	767	767
UltraAVX Screens	83	82	80	77	77	70	66	66
IMAX Screens	23	23	23	23	22	20	20	20
VIP Auditoriums	59	59	56	53	53	50	43	43
D-BOX Locations	62	44	43	38	33	28	25	21

Appendix C

Observable loss in revenue in the second Quarter of 2016

1.1 FINANCIAL HIGHLIGHTS

Financial highlights (in thousands of dollars, except attendance in thousands of patrons and per Share and per patron amounts)	Second Quarter			Year to Date		
	2016	2015	Change (i)	2016	2015	Change (i)
Total revenues	\$ 338,025	\$ 345,540	-2.2%	\$ 716,938	\$ 635,325	12.8%
Attendance	16,858	19,695	-14.4%	37,441	37,233	0.6%
Net income	\$ 7,212	\$ 25,478	-71.7%	28,667	36,005	-20.4%
Box office revenues per patron ("BPP") (ii)	\$ 9.62	\$ 9.45	1.8%	\$ 9.48	\$ 9.19	3.2%
Concession revenues per patron ("CPP") (ii)	\$ 5.74	\$ 5.50	4.4%	\$ 5.58	\$ 5.35	4.3%
Adjusted EBITDA (ii)	\$ 42,768	\$ 65,310	-34.5%	\$ 99,908	\$ 105,558	-5.4%
Adjusted EBITDA margin (ii)	12.7%	18.9%	-6.2%	13.9%	16.6%	-2.7%
Adjusted free cash flow (ii)	\$ 25,554	\$ 41,012	-37.7%	\$ 69,532	\$ 68,489	1.5%
Adjusted free cash flow per common share of Cineplex ("Share") (ii)	\$ 0.403	\$ 0.650	-38.0%	\$ 1.097	\$ 1.086	1.0%
Earnings per Share attributable to owners of Cineplex ("EPS") - basic	\$ 0.12	\$ 0.40	-70.0%	\$ 0.47	\$ 0.57	-17.5%
EPS - diluted	\$ 0.12	\$ 0.40	-70.0%	\$ 0.46	\$ 0.57	-19.3%

(i) Throughout this MD&A, changes in percentage amounts are calculated as 2016 value less 2015 value.

(ii) See Section 16, Non-GAAP measures.