Cinemark Holdings, Inc. (NYSE: CNK US Equity) – Long

Valuation Scenarios	BASE	BEAR	BULL
2019E EBITDA	830	760	880
EV/NTM EBITDA	7.5	6.4	8
2018 Price Target	$42.9	$31.3	$49.9
Return	19%	(13%)	39%
Dividend Yield	3%	1%	3%
Total Return	22%	(12%)	42%

Capitalization As of 10/13/17	
Price	$ 36.29
Shares Outstanding	116
Market Cap	4227
(-) Cash	561
(+) Total Debt	2043
(+) Minority Interest	11
Enterprise Value	5720
Dividend Yield	3.09%
52 Week High	$ 44.84
52 Week Low	$ 32.03
EV/EBITDA NTM	7.5x

Recommendation

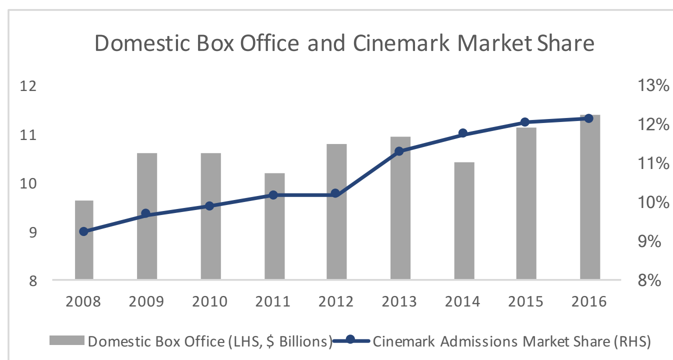
Buy Cinemark Holdings, Inc. with a December 2018 Price Target of $42.9, yielding a 22% total return. The Price Target is derived from my 2019 estimates and an undemanding 7.5x EV/NTM EBITDA multiple, a discount to its 3 year historical average of 8x.

1) Recent box office weakness and attendance decline masks otherwise good industry
2) PVOD (Premium Video on Demand) threat overplayed by street
3) Best-in-class operator with Latin American market growth accelerating, forecast 60 bps of EBITDA margin expansion to 25%
4) Low leverage, interests aligned with shareholders

Business Description

Cinemark Holdings is the third-largest domestic exhibitor and largest Latin American exhibitor. As of 06/30/2017, it had 337 theaters and 4544 screens in the US, and 192 theaters, 1382 screens in 15 countries across Latin America. Latin America accounts for ~25% of Cinemark's revenues, and its largest presence is in Brazil (30% market share), Argentina (36% market share) and Chile (35% market share).

1) Q3 box office weakness and attendance declines masks a fundamentally good industry. Q3 box office was down 14% YoY, and from 2002, attendance has declined 16%. However, in the same period, average ticket price has increased 49%, leading to a 25% increase in the total box office**.** Furthermore, the North America exhibitor market is a highly consolidated and mature industry. According to NATO, AMC, Regal, and Cinemark account for 50% of domestic screens, and total screens in the US only increased 1.5% from 2011-2016. Recently, the ability to invest in reclining seats, expand concessions, and acquisition activity allowed the top players to differentiate and distance themselves from smaller competitors – whereas the domestic box office only grew 11.9% between 2011-2016, Cinemark's admissions revenue grew 33.4%, and overall revenue grew 40%.



On the contrary to worries that Netflix would destroy cinema, the exhibition industry has demonstrated long term growth through multiple technological disruptions and economic cycles. According to the MPAA, the box office has set records 4 out of the past 5 years, and overall attendance has remained steady the past 2 years, with attendance up in the crucial 18-24 and 25-39 age segments. Cinemark has seen attendance grow at a steady 2% CAGR domestically over the past 5 years.

The street is hyper focused on quarter-to-quarter box office performance, whereas annualized performance matters more. If Beauty and the Beast, which was released mid-march, was shifted one week later this year, then Q1 would be down instead of being up 4.5%, and Q2 would be up. Q3 this year was especially weak, as there were only 38 wide releases compared to 45 in 2016. Exhibitors believe that Q4 should be especially strong, leading to flat or improved annual performance. In 1H2017 1% increase in EBITDA, reflecting that Cinemark's fundamental story remains unchanged. Q4, with Justice League and Star Wars, could be a near-term catalyst.

2) PVOD (Premium Video on Demand) overhang unjustified. There is no consensus amongst studios and exhibitors, any mutual agreements should have minimal or even positive financial impact with revenue sharing terms. In 2010, the NYT had already reported: "Studio executives say they are going to risk premium V.O.D. anyway, contending that they have little choice, given the DVD downturn." I see no changes in the exhibitors' negotiating position, as they are still a key part in the movie value chain: 1. Roughly 50% of major motion picture revenue are through film exhibitors; 2. Theatric success makes the market for ancillary sales, as fees that downstream providers pay for movies, as well as international exhibition, are often based on box-office sales; 3. PVOD cannot be effectively priced (generate 2-4x revenue by selling multiple tickets instead of one at home) and could result in TV-like commoditization. The largest risk is if

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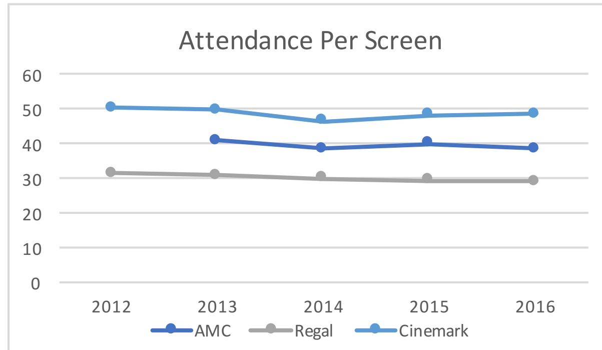
studios unilaterally implement PVOD, but that is highly unlikely, given past cases with exhibitor boycotts and the threat of mutually assured destruction. Moreover, even in this worst case scenario, the financial impact is still likely to be limited given only a subset of films will be launched with PVOD, not all studios would participate, and not all attendees will choose to adopt PVOD.

3) Cinemark is a best-in-class operator, Latin America circuit positive differentiator, EBITDA margin expansion 60bps to 25% through recliner conversion, expanded concessions offering, and Private Label PLF (Premium Large Format). Cinemark has outperformed the industry on YoY admission revenue growth 30 quarters of the past 34. It leads the exhibitors in key metrics, with industry leading EBITDA margins (25%, versus AMC: 17.5% and Regal: 19.7%) and attendance per screen. This can partially be attributed to operational excellence, including spending more on capex on its existing theaters than its peers, and focusing on attendance by keeping ticket prices low (In US circuit, $7.55 versus AMC: $9.59 and Regal: $9.43). Furthermore, Cinemark tends to operate more in suburban areas and local markets compared to peers AMC and Regal, as for example Cinemark has no theaters in New York and over-indexes in the Central-Southwest.



Cinemark entered Latin America 20+ years ago and is the largest exhibitor in the region. Latin America remains a significantly underpenetrated market – population per screen in the US is 8, and the leader in the region, Mexico, is 20.3, compared to Brazil, Argentina, and Chile, which are at 67.6, 51.6, and 45.7 respectively. Furthermore, the Latin American box office grew at ~10% CAGR the past 10 years, whereas in the US it was only ~2% CAGR. Recently, Latin American economies were hit hard by weak commodity pricing, slowing mall construction which hampered Cinemark's expansion, however this year consensus is forecasting a turnaround. Furthermore, FX was previously a drag on international revenues, but turned around in the first half of 2017 and delivered a ~3% tailwind to second quarter.

Real GDP Annual Growth Rate (OECD)						
	Screens	2014	2015	2016	2017E	2018E
Brazil	***587***	0.50%	-3.77%	-3.60%	0.68%	1.60%
Argentina	***184***	1.91%	2.25%	1.59%	1.60%	2.76%
Colombia	***170***	-2.51%	2.65%	-2.30%	2.54%	3.05%
Chile	***118***	4.39%	3.05%	1.96%	2.25%	3.00%

Cinemark was late to the recliner conversion, but has outpaced Regal and is on track to convert 40% of screens to recliners by year end. Recliner conversions are seeing returns well above Cinemark's 20% threshold, with average attendance increases of ~40% for the six months after conversion as well as other ancillary benefits, including greater ticketing pricing power, online ticket fees generated by reserved seating, and concession per cap growth nearly twice that of a non-reclined theater. Cinemark has also seen strong concession per cap growth with expanded offerings such as alcohol and greater penetration, and concessions have high incremental margins with ~85% gross margins. Finally, Cinemark's private label PLF (premium large format) XD screens have helped Cinemark's pricing power and margins, as they are 3.9% of their circuit but generate 9% of revenues, with XD revenue up 16% YoY in Q2.

Valuation Scenarios

Base Case: 22% Upside
7.5x EV/EBITDA, discount to historical average, inline with current valuation. *Declining* US Admissions Revenue, Overall 12% topline increase due to 8% increase in Admissions and 20% Concessions Growth, EBITDA Margins 25%

Bear Case: 12% Downside
6.4x EV/EBITDA, bottom of Q3 valuation. PVOD shaves 300 bps off top line, Latin America growth slow, EBITDA margins stay at

Bull Case: 42% Upside
8x EV/EBITDA, inline with 5 year Historical Average, 300bps boost to top line with 300bps improvement in Admissions and 450bps improvement in concessions, EBITDA margins expand

4) Disciplined capital allocation. Cinemark has kept Net Debt to EBITDA at 2.1x, compared to around 4x for AMC, giving Cinemark future optionality. Insiders also hold 11% of existing float, aligning interests with shareholders, and Mark Zoradi purchased a total of $320k worth of shares at an average price of ~$32.5 in August and September.

<u>Risks</u>

1. Film Slate, as lumpy revenue from quarter-to-quarter variation in film releases; 2. FX risk in Latin America, any further downturn in economy could hamper expansion; 3. Shrinking theatrical window

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