

MMA 801 (GL)

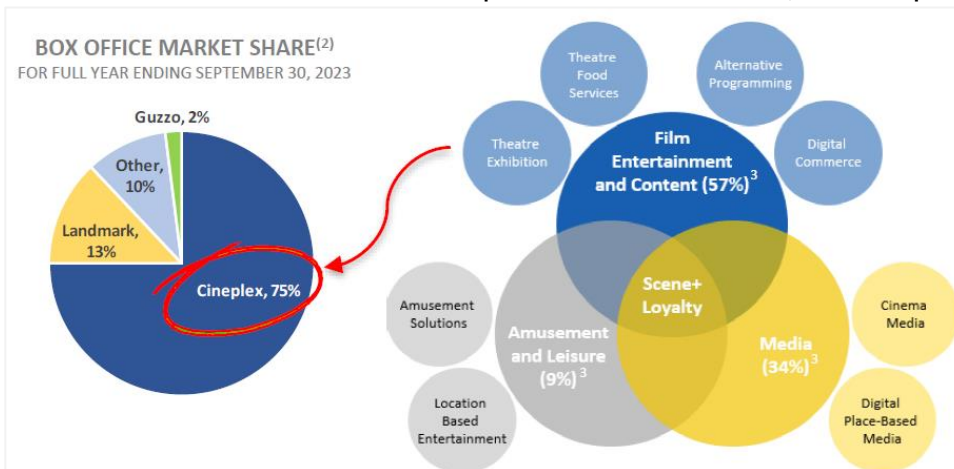
MAY 2024

Case for Exercise 1

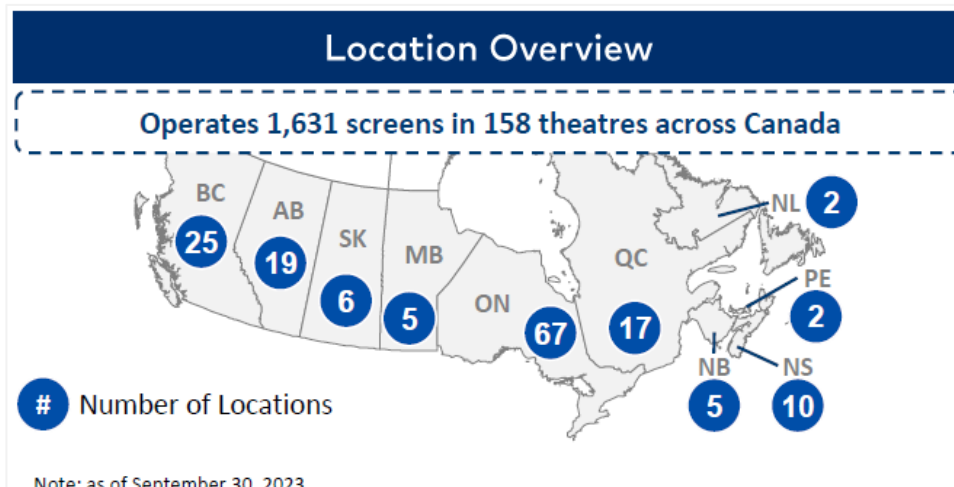
Where Does Cineplex Fit in a Changing Media Landscape?

This case provides a historical reflection on the situation challenging Cineplex both prior to and emerging from the Covid-19 pandemic. Please recognize that, as with any business situation, the overall evolution of the company and the market space within which it operates is fluid and constantly in transition. Readers are encouraged to review the Cineplex MD&A (Q3, 2023) report on the course page on D2L (MD&A stands for management discussion and analysis) to draw conclusions relating to management's proposed direction and overall strategic actions.

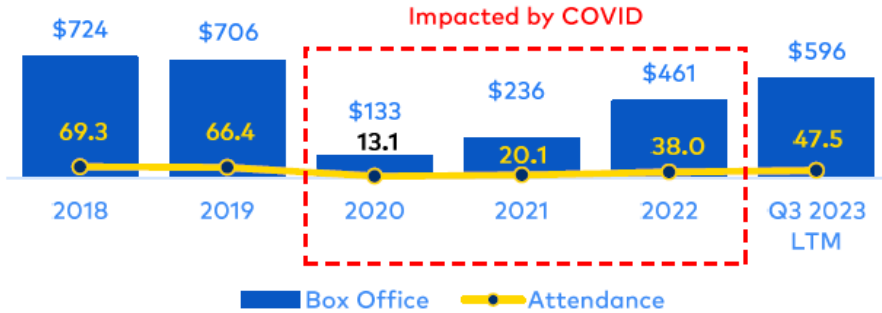
While it may involve some drama, the biggest story playing at Cineplex ([Cineplex Inc.](https://www.cineplex.com)) these days is not on its theatres' screens. With a 75 per cent market share, the company owns and operates Canada's



largest chain of movie theatres. Over the course of the last several years, however, Cineplex has faced declining attendance at its theatres - a situation that has only been made direr by the arrival and impact of Covid-19 and its numerous, subsequent public health mandates, a lengthy writers and actors strike, and the continued evolution of video-streaming alternatives. Yes, there are some current bright spots, in that major box office releases (Top Gun Maverick, Barbie, Avatar, etc.), as well as event releases (Taylor Swift, etc.) have performed well, but overall the market, looking forward, remains challenging. (See inset for Cineplex market share and theatre count at September 2023 (Source: [Cineplex.com](https://www.cineplex.com)))



Box Office Revenue (\$M)



Box Office per Patron (C\$)

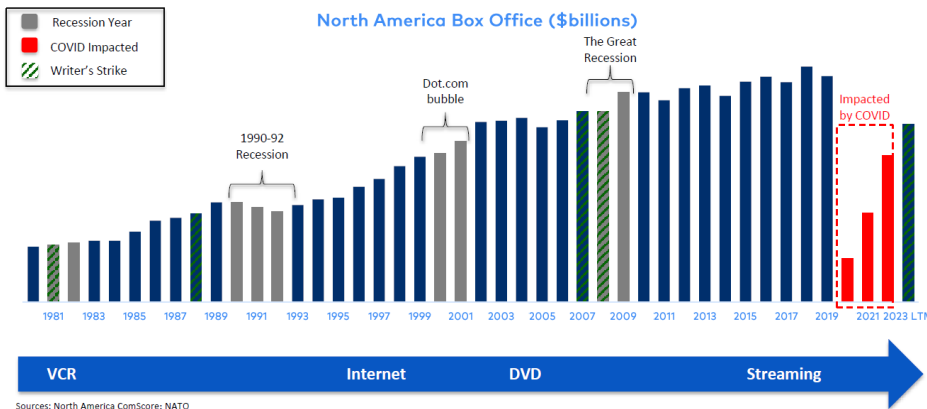


enforce capacity restrictions that, in some instances, limited them to selling seats for only 25 per cent of the theatre in order to meet social distancing requirements.¹ At one point, Cineplex was forced to lay off 5,500 of its 13,000 employees in Canada. (See inset for the effect of the imposed restrictions on topline performance at Cineplex. Source: Cineplex.com).

While the pandemic was certainly an unwelcome disruption to the company, it alone was not the sole architect of Cineplex's recent challenges. (See inset for the impact of macro economic shocks on North American theatre business over time)

EXHIBITION INDUSTRY TRENDS

The theatrical exhibition has historically exhibited growth throughout recessionary periods and technological disruptions



plummeted by more than 10.5 million theatre visits a year, compared to five years earlier.² The two years before the pandemic had seen the company's share price drop by 37 per cent and profits fall by 63 per cent.³

The Impact of Covid-19

While many industries were affected when the Covid-19 pandemic spread around the world beginning in March 2020, the Canadian cinema industry was hit particularly hard. That's when gathering spaces, including restaurants, malls, and movie theatres, were targeted with a variety of public health restrictions designed to curb the spread of Covid-19. However, while restaurants were at least able to shift their operations to "takeout only" and the retail sector was able to set up "curbside pickup" to keep business moving along, movie theatres faced extended periods where they were forced to either close completely or

Declining attendance pre-pandemic

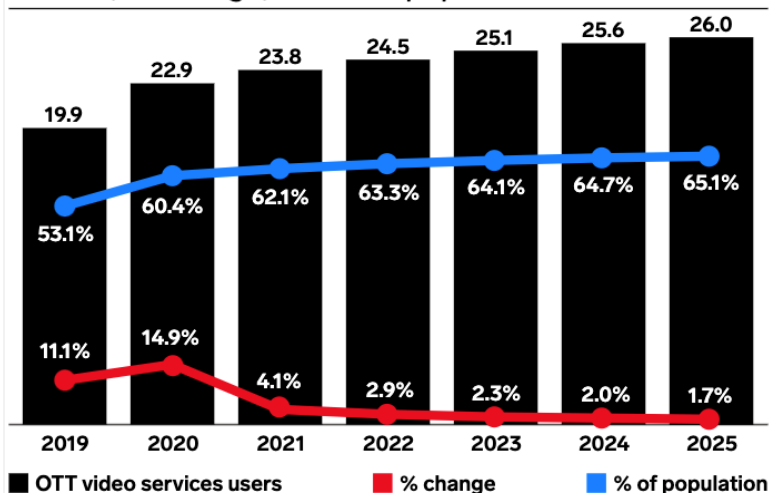
Cineplex was already at a crossroads before the Covid-19 pandemic arrived in Canada in early 2020. By the end of 2019, overall Cineplex attendance had

That's why few were surprised when Cineplex announced in December 2019 that it had [an agreement in place](#) that would see the company acquired by UK-based Cineworld Group PLC. Cineworld's move to purchase Cineplex was widely understood throughout the industry "as a rescue to help the Canadian firm cope with horrid industry conditions and an over-leveraged balance sheet."⁴

At the time of the sale to Cineworld, Cineplex CEO Ellis Jacobs hailed the deal, saying: "The entertainment industry continues to transform, and we are pleased that through this agreement we are ensuring Cineplex is part of the next era of global entertainment."⁵

Subscription OTT Video Service Users in Canada, 2019-2025

millions, % change, and % of population



Note: individuals of any age who watch video via any app or website at least once per month that provides paid subscription access to streaming video content over the internet and bypasses traditional distribution; examples include Amazon Prime Video, HBO Max, Hulu, Netflix, Sling TV, and YouTube Premium; OTT video services are not mutually exclusive; there is overlap between groups
Source: eMarketer, Sep 2021

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While the Cineworld deal to acquire Cineplex would fall apart [just six months later](#) in June 2020, Jacobs wasn't wrong about the industry being in transition. What remains to be seen, however, is whether the Cineplex theatre chain is indeed "part of that next era."

Changing Tastes

Much of Cineplex's historical decline in attendance has been attributed to the change in how Canadians like to watch films – a change led by the proliferation in recent years of handheld smart devices, both mobile phones and tablets – and the rapid adoption by Canadians of over-the-top (OTT) subscription streaming services such as Netflix, Prime Video, Disney Plus, and regional players like Bell Media's Crave.

Although it is still a relatively nascent industry, Canadians continued to demonstrate throughout the pandemic that they very much enjoy their OTT services and the convenience of being able to access the video content of their choosing anywhere, at any time (see Exhibit 4). In 2021, Canada ranked third in the world (37.4 per cent) of countries with the highest penetration rate of OTT subscription services, trailing only the United States (45.7 per cent) and Sweden (40.4 per cent).⁶ By 2025, it's estimated that nearly a full two-thirds of Canadians will be regular users of OTT services.⁷ (See inset for penetration of streaming services in Canada. Source: eMarketer)

Not only has overall OTT service adoption increased across Canada, but each of the major OTT service providers operating in the country has enjoyed subscriber growth. (see Appendices A, B, C, and D for additional background information)

Such growth across OTT services poses a direct threat to Cineplex, particularly as it looks for ways it can draw moviegoers back into its theatres in time to break any new viewing habits that they might have developed over the course of the pandemic.

“New Viewing Habits”

While OTT services are a direct challenge to Cineplex and the cinema industry, the larger movie industry does not necessarily see it the same way. With theatres closed, not only in Canada but around the world, movie studios began looking at OTT services as one way to hedge their bets in the face of the pandemic. Disney’s live-action *Mulan*, for example, saw its North American premiere on Disney Plus in September 2020 after its intended theatrical opening date was pushed back twice. The film was finally removed altogether from the company’s release calendar due to covid-related uncertainty.

With a premium price of \$29.99, in addition to the monthly Disney Plus subscription fee, Disney saw *Mulan*’s OTT release as “serving as a valuable test case to determine how much of their hard-earned cash customers are willing to part with in order to watch a movie that was originally intended to debut exclusively in cinemas.”⁸

Other movie studios soon followed suit. Citing the pandemic, Warner Bros. Pictures studio, owner of HBO and HBO Max, announced in December 2020 that its “entire 2021 slate of films [would] be available for audiences to stream on HBO Max [but only] in the U.S.”⁹ This included first runs of blockbuster films, including *The Batman* and the new remake of *Dune*.

Disney and Warner Bros. are both continuing to release films in theatres. Will they continue doing so should another interruption to their business appear?

Meeting the Challenge

Moving forward, Cineplex knows that it has its hands full. After years of declining attendance and two years of pandemic related losses, the company has been relatively slow to indicate and to fully roll out how it intends to address the changing tastes of moviegoers.

Cineplex’s major significant move during the pandemic, was the launch its new CineClub subscription service August 2021. The service is being marketed as “The Movie Lover’s Monthly Membership.” The commitment-free service provides subscribers with one movie ticket per month, an option to buy a second ticket at \$9.99 in the same monthly period, and 20 per cent off concessions. This service is in addition to the Scene loyalty rewards program that is run in partnership with Scotiabank. Benefiting from a stronger than expected first 9 months of 2023, Cineplex’s current financial performance does offer it some short-term breathing room. Major movie releases, although few in number have performed better than expected. The addition of events such as Taylor Swift’s and Beyoncé’s have added additional welcomed revenue. concession sales continue to stay strong and amusement & leisure revenue has contributed positively to the bottom line. The end result is that profitability, although small, returned in 2023. (See inset for selected results. Source: Cineplex.com)

Although the good news for Cineplex and cinema operators at large is that audiences have returned to the cinemas and are spending more when visiting. The major headwind, however, is that cinema releases are down considerably (-50%) from the same period of 2021, and down -21% from 2019 levels.

HIGHLIGHTS OF THIRD QUARTER 2023 RESULTS



Theatre Exhibition

- Outperformed North American box office recovery by 9% when comparing Q3 2023 to Q3 2019
- Third quarter box office revenue record of \$188.2 million
- Premium format represented 35.0% of box office



Per Patron Spend

- Q3 record box office revenues per patron of \$12.00, up 6.7% from Q3 2022 and up 18.1% from Q3 2019
- Q3 concession revenues per patron was \$8.44, up 1.1% from Q3 2022 and up 26.3% from Q3 2019



Amusement & Leisure

- Q3 record revenue of \$49.0 million in P1AG, an increase of 7.7% from Q3 2022
- Reported third quarter record revenue of \$34.2 million in LBE, 10.2% increase from Q3 2022
- Reported third quarter record adjusted store level EBITDAaL of \$9.9 million in LBE



Media

- Media revenues increased 15% over Q3 2022



Loyalty & Subscription

- CineClub program crossed 130,000 members in Q3 2023
- Over 14 million Scene+ members, representing one-third of the Canadian population and 15 years of history



Profitability

- All-time quarterly record adjusted EBITDAaL of \$83.1 million compared to \$20.4 million in Q3 2022
- Delivered \$66.9 million of adjusted free cash flow compared to \$1.6 million adjusted free cash flow in Q3 2022

Production delays have resulted in an attendance downturn in Fall 2022, and this is anticipated to continue into the front-end of 2024.

The war with streaming also shows no signs of letting up. Amazon, Disney+ and Netflix, in particular have all committed to large content development

budgets to maintain their customer bases and minimize customer desertion, as pandemic concerns dissipate. Some mutual synergies are emerging, such as Netflix's partnering with cinemas (including Cineplex) with limited release windows for new movie releases (such as Glass Onion: A Knives Out Story), but the thin pipeline of big movie releases, coupled with the growing belief that the future of entertainment is streaming, will challenge the cinema sector to think of other innovative ways to fill seats. Netflix, as an example, views the limited release to theatres as more of a promotional ploy, versus a belief (at least at this point) that such releases will have any significant impact on subscription growth and retention.

Cineplex's partnership arrangement with Scene has also changed. With the launch of Scene+, members now have broader choice as to where and how to spend their scene points. The good news is that, with the addition of Empire Company Limited, and Scotiabank's renewed involvement in the loyalty program, Scene+ has grown to over 15 million members. Empire's involvement allows scene members expanded opportunities to earn Scene+ points. The question, for Cineplex will be how to ensure that it maintains its ability to capture a lion share of these redemptions.

Referred to earlier in this commentary, in June 2022, Cineplex quietly launched an online booking fee for ticket purchases online or through its mobile app. The per ticket fee structure is as follows:

Non-Scene Members - \$1.50

Scene Members - \$1.00

CineClub Members - \$0.00

In-person purchases at the box office, ticket kiosks, or concession stands would not be charged the booking fee. The company has also implemented, at some of its busier theaters, a \$2.00 fee for prime seats, and is also experimenting with surcharges for reserved seats at stronger theater showings.

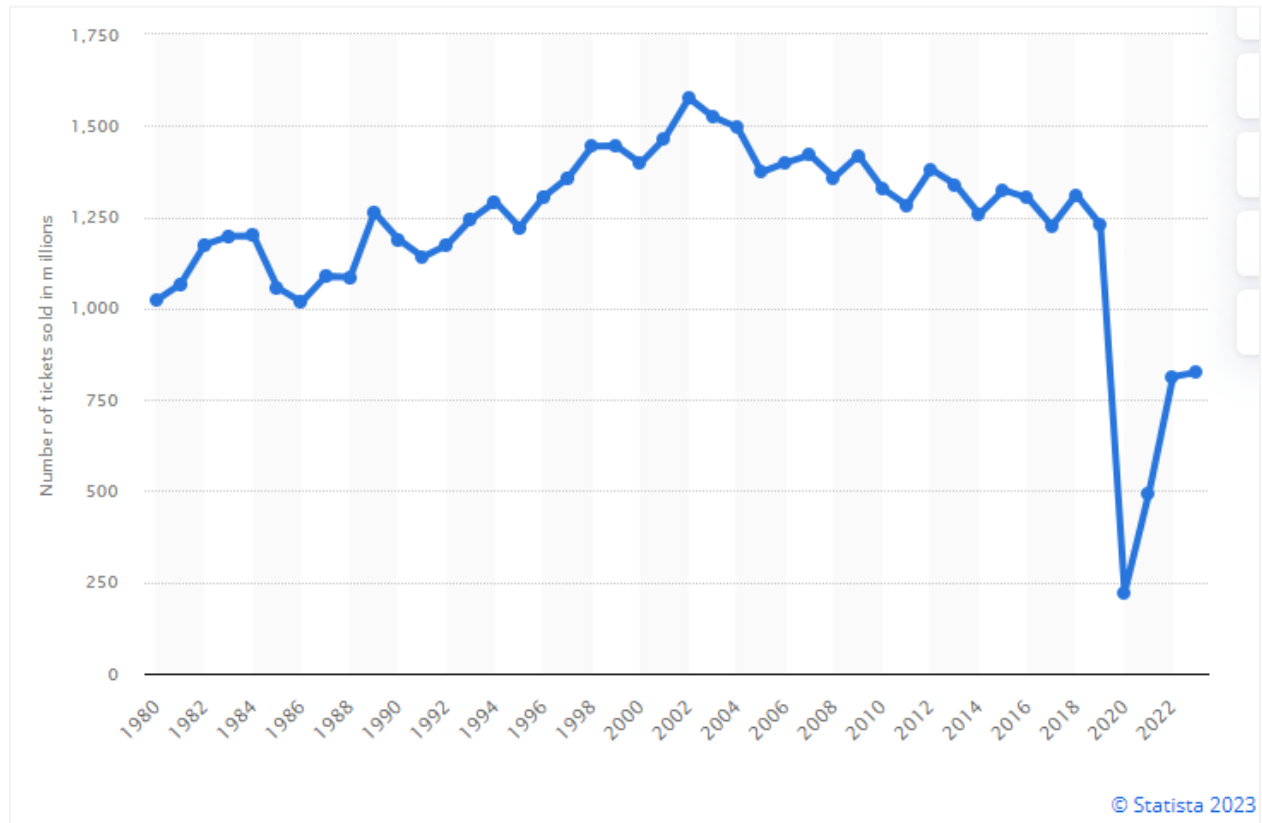
Where does Cineplex go from here?

Given the shift in consumer behaviour, where does Cineplex go from here and how does it fit into this ever-changing landscape? Is diversification around games and food enough to generate the type of

experience that customers will leave their homes for? Exactly where and how should Cineplex use its facilities and allocate our resources to stimulate traffic to our locations and encourage customers to spend more time and money with the organization?

Appendices

Appendix A: Attendance - # of Tickets sold in the U.S.A. and Canada from 1980 to 2022 (Millions)



Appendix B: Number of Theatre Releases

Characteristic	Number of movies released
2022	449
2021	406
2020	334
2019	792

Appendix C: Netflix Viewers in Canada, 2019-2025

Netflix Viewers in Canada, 2019-2025							
	2019	2020	2021	2022	2023	2024	2025
Netflix viewers (millions)	16.2	18.0	18.6	19.0	19.3	19.6	19.9
—% change	7.6%	11.3%	2.9%	2.1%	1.9%	1.7%	1.5%
—% of internet users	49.3%	54.0%	54.7%	55.1%	55.4%	55.7%	56.0%
—% of population	43.3%	47.7%	48.5%	49.0%	49.4%	49.7%	50.0%
—% of digital video viewers	61.9%	66.8%	67.0%	66.7%	66.4%	66.3%	66.2%
—% of subscription OTT video service users	81.5%	78.9%	78.0%	77.4%	77.1%	76.8%	76.7%
<i>Note: individuals of any age who watch Netflix via app or website at least once per month</i>							
<i>Source: eMarketer, Aug 2021</i>							
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Appendix D: Amazon Prime Video Viewers in Canada, 2019-2025

Amazon Prime Video Viewers in Canada, 2019-2025							
	2019	2020	2021	2022	2023	2024	2025
Amazon video viewers (millions)	7.0	10.7	12.2	13.3	13.9	14.3	14.7
—% change	117.8%	51.9%	14.3%	8.9%	4.4%	3.0%	2.7%
—% of internet users	21.4%	32.0%	36.0%	38.7%	39.9%	40.6%	41.3%
—% of population	18.8%	28.2%	31.9%	34.4%	35.6%	36.2%	36.8%
—% of digital video viewers	26.9%	39.6%	44.1%	46.8%	47.9%	48.3%	48.8%
—% of subscription OTT video service users	35.4%	46.8%	51.4%	54.4%	55.5%	56.0%	56.6%
<i>Note: individuals of any age who watch Amazon Prime Video via app or website at least once per month</i>							
<i>Source: eMarketer, Aug 2021</i>							
269234	eMarketer InsiderIntelligence.com						

Appendix E: Crave Viewers in Canada, 2019-2025

Crave Video Viewers in Canada, 2019-2025							
	2019	2020	2021	2022	2023	2024	2025
Crave viewers (millions)	5.9	6.6	6.8	6.9	7.1	7.2	7.3
—% change	13.3%	11.6%	3.6%	2.4%	2.3%	1.7%	1.5%
—% of internet users	17.9%	19.6%	20.0%	20.2%	20.4%	20.5%	20.6%
—% of population	15.7%	17.3%	7.7%	18.0%	18.2%	18.3%	18.4%
—% of digital video viewers	22.4%	24.2%	24.5%	24.4%	24.5%	24.4%	24.3%
—% of subscription OTT video service users	29.5%	28.7%	28.5%	28.4%	28.4%	28.3%	28.2%
<i>Note: individuals of any age who watch Crave via app or website at least once per month</i>							
<i>Source: eMarketer, Aug 2021</i>							
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Appendix F: Disney Subscription Services

Note: Disney Plus reports its Canadian and US-based subscribers in a single bundle as “domestic subscribers.” According to reports, Disney Plus gained 200,000 domestic subscribers in Q4 2022 for a total of 161 million subscribers globally.¹⁰ For all markets, Disney Plus, reported a decrease of 2.4 million subscriptions, largely driven by its loss of the Indian Premier League (Cricket) in Southeast Asia¹¹ Disney’s own projections have the total number of subscribers, from all of its streaming services at 221 million.¹²

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N.B.: This is an adaptation of a case originally prepared by Prof. G. Bissonette.