$AMC : That escalated quickly

Well, that escalated quickly.

I mentioned AMC (disclosure: long, unfortunately) on the blog ~a month ago. Last night, the company provided preliminary Q2’17 and FY17 guidance that could only be described as disastrous. The stock has certainly responded today, down ~25%, and the rest of the movie theater sector is performing much better (NCMI down 16%, CNK down 6%, RGC down 5%, IMAX down ~8%). So I guess given the share price performance it be more accurate to say that de-escalated quickly.

I find writing both therapeutic and clarifying, so let’s talk about a few different angles here.

First, how bad were results? Well, the company is reporting ~$135m in Q2’17 EBITDA. If I go look at the historical numbers they provided, I can see the whole combined company did $175m in PF EBITDA in Q2’16. So EBITDA was down 20-25% YoY. That’s a pretty bad headline result, but the numbers are actually even worse when you dig into them. First, remember that they closed on Odeon, Carmike, and Nordic in the past year, so this quarter’s adjusted number should include the benefit of some synergies. Second, revenue only declined ~3% YoY (from $1.24B last year to ~$1.2B this year), so EBITDA margins were down significantly. Given a decent piece of the cost structure is relatively variable expenses like film rental, it makes no sense at all that a small revenue decline like that would cause such a huge EBITDA drop / margin compression. The company provided no explanation / backdrop into why expenses were up / margins were down so much (honestly the drop was so big I initially thought they weren’t adding back merger integration expenses, but they are), so the decline is both frightening and a major area for questioning heading into the full earnings announcement next week.

Ok, so the Q2 numbers were bad. What about the full year guide? The company is calling for ~$5.2B in revenue and $880m in EBTIDA (roughly midpoints of full year guidance). However, that guidance isn’t apples to apples to last year’s proforma numbers ($5.26B in revenue; $904m in Adjusted EBITDA) for three reasons

1. There should be some synergy benefits in this year’s numbers; unfortunately, we can’t figure out how much of a benefit from synergies there are.
2. The company is guiding for $30m in EBITDA boost from a cost cutting program started in July 2017; take that out, and apples to apples EBITDA goes from $880m this year to $850m
    a. I’m also not sure how much credit to give them for this $30m. While I’ve been calling it cost cutting, the company described it as a “cost reduction / revenue enhancement initative”. The revenue enhancement includes strategic pricing and a few other

things that seem like standard business improvements, not something that should be highlighted as a cost cutting initiative / EBITDA enhancer.

3. The company closed on Nordic on March 31, so only nine months of Nordic are included in the guide. Nordic did ~$21m in EBITDA in Q1'17 (based on $13.2m in EBIT plus $4.9m D&A plus $3.2m in M&A expense), so add that back and you get a comparable EBITDA of ~$901m.

Ok, so if I add back the Nordic earnings but subtract the additional cost cutting, I get a "like for like" EBITDA number of $871m this year versus $904m last year. Again, we don't know how much in realized synergies are included in that $871m, but this like for like number doesn't seem so awful- full year EBITDA drops by $33m, and more than all of that is driven by the massive Q2 miss (down $40m YoY). Which, again, leads us to the question: what the hell happened in Q2?

Final question: is the share freefall today an overreaction? I wish I had a great answer here. I lean towards no for a few reasons: faith in management has to be shot at this point (remember: in Q1 they said the integration was going well, and they gave no hint something this bad was coming), something truly strange happened in Q2 given the massive earnings drop and it's tough to get comfortable on what it was given the limited clarity from management, and a 25% stock price move obviously hurts bagholders like me but given how levered AMC is it's only a 10% move in their EV, which honestly feels a bit light given how awful the quarter was. But you could talk me into this being an overreaction- the full year guide seems ok absent the Q2 issues, and 2018 should look pretty strong given an anticipated box office recovery plus fully annualizing the $30m in "strategic initiatives" they just announced.

A few more things on management before wrapping this up: someone on twitter posted something along the lines of "AMC is what happens when management overpays for assets and doesn't integrate." I think that's directionally correct: AMC was paying top dollar for assets, and Q2 clearly shows there was no benefit to putting the assets together. But still- how could they bungle Q2 this badly? These are freaking movie theaters- how bad can integration issues really be? If you buy a tech company and bungle integration, all the employees (the most valuable piece of many tech companies) leave and/or all of the customers (the other most valuable piece) get pissed off and put out an RFP for a new vendor. If you buy a movie theater, all you're really doing is hanging up a new sign, right? There shouldn't be much wholesale change that impacts the core operations. It just doesn't make sense to me. I'm not sure it makes sense to AMC management either- the CEO bought 10k shares at $24.715 in early June, and I'm not sure why he'd buy shares in early June knowing how bad Q2 was about to be. Honestly, it just continues to raise red flags: maybe he didn't know how bad the Q was shaping up? Is that another indication that the company is just purely botching integration / slowly exploding with no grasp on the numbers? Or does it show that there were some really unexpected and onetime expenses towards the end of Q2 that they're going to discuss on the earnings call next week?

If I update my cap structure for today’s NCMI price of ~$6 and AMC at ~$15.50, I get AMC’s EV at ~$6.4B. The midpoint of Adjusted EBITDA is $880m, and if I pull out the projected ~$38m in EBITDA from NCMI, I get to a “core AMC” EBITDA of ~$842m, meaning AMC today is trading for just a tick over 7.5x EBITDA. Part of the updated guidance included dropping gross / net capex spend for 2017 from ~$725M / $570m to ~$635m / $525m. I would guess capex remains muted heading into 2018- I had previously pegged MCX at around $300m/year, and if they go that low AMC would throw off a wild amount of FCF next year (~$550m unlevered assuming EBITDA stays flat (a large assumption given how bad Q2 was), ~$300m FCF after interest and minimal taxes due to NOLs). With a market cap of ~$2B after the share decline, that looks pretty attractive, but the questions and red flags for AMC continue to rise.

Note: this post was written pretty quickly, so it’s 100% possible any or all of the above initial thoughts are off. We’ll know a lot more after earnings next week. I may or may not do an update then.