Value Investors: Cineplex (TSX:CGX) Stock Hasn't Been This Cheap Since 2010

Description

In theory, value investing is a straightforward exercise. You buy shares of beaten-up stocks when the market is most bearish and hold for a while. You wait for business fundamentals to recover and then sell the stock for a nice profit.

Easy, right?

As any experienced investor knows, the process isn't nearly that simple. Most depressed stocks are that way for a reason. After all, the collective wisdom of everyone in the stock market is a pretty powerful force. Some of these stocks recover, while many don't. The secret is being able to separate the good from the bad — something that can be difficult for even seasoned investors.

But the payoff can make it all worth it. Beaten-up stocks often offer huge upside potential. We're talking returns of 100%, 200%, or even higher, all in a few short years.

If that kind of potential sounds good to you, then you'll want to check out **Cineplex** (TSX:CGX) stock today. Here's why this depressed value stock offers tremendous potential.

A fixable problem

The economic slowdown has impacted a lot of sectors, with perhaps none more affected than movie theatres. Nobody is going to the movies today, because there are no theatres open.

Additionally, people stuck at home are fully embracing video streaming, a content model that has been giving the traditional movie business fits for years now. There are now multiple streaming services for Canadians to choose from, content that costs less per month than a single trip to the movies.

But that doesn't mean the movie theatre business — or Cineplex stock — is doomed. Millions of Canadians still enjoy a night out at the movies. In fact, we collectively made some 66 million trips to Cineplex's theatres in 2019. This isn't an industry that will go away forever, even if it does take months to get people back into seats.

Yes, the sector will continue to struggle, even when the economy inevitably reopens. Even if governments don't force theatres to implement some sort of physical distancing practices, consumers will demand it. But the problem will fix itself over time, as the world returns to normal. In fact, I see a scenario playing out where many top movies come out in 2021, creating demand that pulls people back to the movie theatre.

Valuation

There's no denying it. Cineplex stock is incredibly cheap today.

I realize there's no way the company will be able to replicate 2019's earnings this year (next year looks dicey, too), but I'd still argue last year's earnings are a reasonable proxy for the company's medium-term earnings power. In 2019, Cineplex generated $2.66 per share in adjusted free cash flow.

As I type this, Cineplex stock trades hands at $14 per share. That puts the stock at a price-to-free cash flow ratio of just 5.3 times. You won't find many cheaper stocks, and the market is full of inexpensive names.

Investors should also remember it was just a few months ago Cineworld, the big U.K.-based theatre operator, bid $34 per share for Cineplex. This deal will certainly be called off, but it just goes to show what Cineplex stock would be worth during more normal times.

The bottom line on Cineplex stock

The last time Cineplex shares traded this cheaply was 2010. This was immediately after a year where the company generated $965 million in revenue and adjusted EBITDA of $160 million. Compare that to today, when the company is coming off a year when it generated $1.7 billion in revenue and more than $400 million in adjusted EBITDA.

In other words, if you believe the economy will return to normal relatively soon, Cineplex's valuation doesn't make much sense today. This could be a massive comeback story, one that could make you a lot of money.

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