COVID-19: 2 Battered Stocks That May Not Recover

Description

The COVID-19 crisis has wreaked havoc on the Canadian economy. Many hard-hit sectors have been decimated, and although there are opportunities to buy into such sectors on the cheap to play an abrupt recovery, investors should realize that there are areas where such a recovery may be more muted.

With certain securities that are at ground zero of the crisis, investors must ensure that they're not overpaying for a name with the assumption that things will return to normal by 2021 and that an effective vaccine will be readily available for distribution sooner rather than later.

While I am of the belief that some of the hardest-hit areas of the economy will recover in due time, investors must watch out for firms with less-than-stellar liquidity and solvency positions or firms with high cash burn rates, as they may not live long enough to see their broader industries recover.

This piece will have a look at two businesses that have a high probability of not recovering from this unprecedented crisis.

Cineplex: Crushed by COVID-19

Cineplex (TSX:CGX) is a movie theatre giant that prudent investors would be wise to steer clear of at this juncture. While I am of the belief that people will return to the movies once it's safe to do so, I worry that Cineplex may not survive long enough to ride the recovery in the broader movie theatre industry.

As the economy reopens in phases, places that involve crowding, such as theatres, are among the last of establishments to be given the green light. Moreover, with a second COVID-19 outbreak that could happen in the future, the movie theatres could face another several months' worth of lockdowns and lost revenues.

For a firm like Cineplex, which doesn't have a good liquidity or solvency position (0.3 quick ratio and 0.4 current ratio), the company will be facing an uphill battle, and there's no telling how much further its stock can sink. Sure, a timely arrival and distribution of a vaccine could avert a disaster for Cineplex, but in any other scenario, Cineplex will be fighting for its life.

Shares look cheap at 1.4 times book, but they can get much cheaper should this pandemic continue dragging on. Unless Cineplex can raise significant liquidity to better weather the COVID-19 typhoon, I fear the stock could be headed towards $0.

H&R REIT: Don't rule out another distribution cut

H&R REIT (TSX:HR.UN) just took its distribution to the chopping block. Many retirees who depended on the REIT for monthly income found themselves holding the bag as the COVID-19 crash struck, with the one-two punch of a distribution reduction and substantial capital losses.

In the age of COVID-19, the stay-at-home and work-from-home economies aren't going anywhere soon, and that doesn't bode well for H&R REIT and lofty exposure to office and retail real estate.

While I am a fan of the valuation on the REIT at this juncture, I'd only urge super-long-term investors to consider getting into the name, as rent deferrals could continue mounting, while other firms consider walking away from their leases whenever they come due. Moreover, any recovery in office or retail space, I believe, will be more L-shaped in nature, given a greater exposure to small- and medium-sized businesses, which are most vulnerable amid this crisis.

Fortunately for H&R REIT, leases are long term in nature. But as headwinds continue mounting, investors should not rule out a scenario where the distribution is slashed again. Another COVID-19 outbreak could trigger another wave of selling, and the distribution may not be as stable as it seems after the latest reduction.

Unlike Cineplex, H&R REIT won't run out of cash. It'll just have to pay out less to its shareholders, and to many, a second distribution reduction will be viewed as unforgivable.

CATEGORY

1. Coronavirus
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

1. TSX:CGX (Cineplex Inc.)
2. TSX:HR.UN (H&R Real Estate Investment Trust)

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