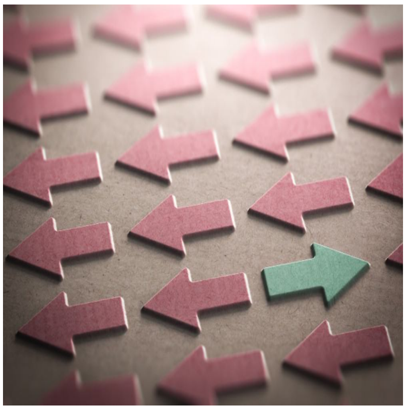

Better Contrarian Buy: Air Canada (TSX:AC) vs. Cineplex (TSX:CGX)

Description

The COVID-19 pandemic continues to impact several industries. The worst-hit are companies part of the airline, tourism, hospitality, and entertainment sectors due to business shutdowns and lower consumer spending. Canadian companies such as **Air Canada** (TSX:AC) and **Cineplex** (TSX:CGX) are currently trading 66% and 71%, respectively, below their 52-week highs.

While international and domestic travel has come to a standstill, entertainment avenues such as arcades and cinema halls have also been shut. So, are the two beaten-down stocks trading at attractive levels for contrarian investors?

Air Canada stock was flying high before COVID-19 struck

While Air Canada stock has lost significant market value in recent months, it was one of the top-performing companies on the TSX in the last decade. The stock gained a staggering 3,500% between December 2009 and December 2019.

The company recently announced its results for the June quarter, and it saw operating revenue fall by 88.8% year over year to $527 million. Air Canada's operating loss expanded to $1.55 billion compared to an operating income of $440 million in the prior-year quarter.

Investors should brace for a bumpy ride given the capital-intensive nature of the airline business. Further, high debt levels and a multi-year recovery period will also weigh on Air Canada and investors.

In Q2, the company experienced a 96% decline in passenger count due to government-imposed travel restrictions. While domestic travel restrictions have been eased, Canadians will still be wary of stepping into an airline. Industry experts, in fact, believe the passenger capacity will normalize to pre-COVID levels by the end of 2022.

Air Canada has raised over $5.5 billion in equity, debt, and aircraft financing, which now suggests its total liquidity stands at $9 billion. However, this also means that the company's net debt has increased from $3.27 billion in Q2 of 2019 to $4.56 billion in Q2 of 2020 and is about 90% of Air Canada's market cap.

In Q2, Air Canada's interest expense accounted for a massive 30% of revenue, and additional debt with slowing revenue will keep investors concerned.

Cineplex stock is up 20% in the last month

Entertainment giant Cineplex has seen its price crash to multi-year lows in the first half of 2020 due to country-wide lockdowns. Cineplex stock is now up 20% in the last month and has partially recovered its losses.

One of the main reasons for the recent upward spike was the company's announcement that it would reopen all theatres on August 21. Cineplex CEO Ellis Jacob said the company has "implemented industry-leading health and safety protocols and will continue updating and evolving our practices as necessary to keep everyone healthy and safe."

While the theatres have reopened, investors need to tread with caution. Similar to airline travel, people are likely to delay plans to go and watch a movie during these uncertain times. It is just too risky to venture out to public places, even though precautions are being taken.

Cineplex sales were down 95% year over year at $22 million in the second quarter of 2020 compared to sales of $439 million in the prior-year period. The company is opening its doors once again, giving it a chance to recoup lost revenue.

However, this has to be met with consumer demand, which seems unlikely given that people prefer to stay at home and consume content via streaming services.

Bottom line

Air Canada and Cineplex remain risky bets due to the ongoing pandemic. If there is a second wave of the COVID-19, these stocks will plummet once again and burn massive investor wealth. I think investors can look elsewhere to buy beaten-down stocks that have a better chance of recovery.

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