Cineplex (TSX:CGX) Stock Could Skyrocket, But Is It Worth the Risk?

Description

Cineplex (TSX:CGX) has been in the doghouse well before the COVID-19 crisis decimated the economy and the movie theatre business. Undoubtedly, the pandemic has accelerated the rise of video streamers. Even as Cineplex keeps its doors open in a mostly-reopened economy, there are many reasons to believe that we'll witness more of the same, as people opt to enjoy content from the comfort of their own homes, rather than paying up a hefty price tag for a movie ticket while running the risk of contracting COVID-19.

In this kind of new normal, Cineplex can improve its chances of survival despite having a cap on the number of bums in seats and upped sanitization expenses. Given movie theatres are in the last phase of economic reopening plans, though, the company runs the risk of shutting its doors for extended periods of time on resurgences of the coronavirus.

Moreover, the recent release of big-budget productions straight to stream (think live-action epic *Mulan* on **Disney**+ and Tom Hanks' *Grayhound* on **Apple** TV+) does not bode well for the medium-term outlook for movie theatres, as competition heats up on the video streaming front.

With the Cineworld deal now up in the air, the only real reason to own Cineplex stock is for a takeover. I'm not a fan of playing takeover roulette with businesses that have taken massive hits to their operating cash flows, though.

Cineplex looks cheap, but that doesn't mean it's undervalued

Shares of Cineplex could still get cut in half (again), and the takeover price may end up being far less than the price you paid. As such, investors should ensure they've got a sound thesis before considering initiating a position in the battered movie theatre giant that could feel the COVID-19 impact for years after this pandemic subsides.

In a prior piece, I highlighted the fact that Cineplex was due to see some business erosion because of its horrid financial footing.

Don’t underestimate the risks

“The COVID-19 crisis is likely to put the brakes on the firm’s amusement diversification efforts as it looks to conserve cash in the fight for its survival. Cineplex is limited its spending on growth initiatives with annual capex to drop to $50 million, down from around $150 million. This reduction in spending could delay Cineplex’s reincarnation for years — if it even survives this crisis,” I wrote in a prior piece.

“Fortunately, the box office has reopened, and if all goes smoothly, the company could find itself free cash flow positive within the next two quarters. The company also raised over $300 million worth of capital, improving the company’s liquidity positioning to an acceptable level. Still, growth expectations are now muted, and the company could find itself skating on very thin ice through the duration of this pandemic.”

The next quarter will provide Cineplex with some much-needed relief, but I don’t think it will be a mover on the stock price unless we’re due for positive news relating to COVID-19. At this juncture, the risks of further damage to Cineplex stock is still ridiculously high, given movie theatres are among the firms that have been feeling the greatest impact of this crisis.

Foolish takeaway on Cineplex stock

CGX stock trades at 1.8 times book value, which, while cheap, is not cheap enough for my liking given the downside risks and uncertainties. I’d urge investors to consider waiting for a pullback such that shares trade at a discount to book value before considering initiating a position.

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