Why Cineplex (TSX:CGX) Stock Dropped 29% Yesterday

Description

Investing in **Cineplex** (TSX:CGX) stock today is a bet. It's like trying your luck at the roulette wheel at a casino.

Yesterday, the theatre stock dropped a whopping 29%, as news spread of a renewed temporary theatre shut down at U.S. theatres due to a new wave of virus cases. The concern is that theatres can shut down again in Canadian regions where there are surges in COVID-19 cases.

Think Cineplex stock is super cheap and want to bet on it?

Cineplex stock now trades for pennies compared to pre-pandemic levels. Specifically, the stock closed at $4.75 per share — a massive discount of 86% from its late 2019 levels. If the stock were to climb to the nearly $34-per-share level again, it'd be *seven times* the current levels.

It's difficult to visualize the stock at the $34 level in the current super-challenging operating environment. That said, the oversold stock could experience a dead-cat bounce.

Canadians who're taking bets here should sell into those bounces/rallies, as the stock has great near-term risks. As of writing, the slide hasn't shown any sign of slowing down. If you haven't bet already but are looking to do so, wait for the stock to show some sort of consolidation first to be a little safer.

How risky is Cineplex stock?

Cineplex has too much of its revenues tied to the theatres. If it is forced to close its theatres again, it can't possibly get much revenues. For example, during the second quarter (Q2), its theatres were forced to close, and its revenue dropped 95% year over year!

Needless to say, this caused the company to lose money — specifically, it posted a net loss of $98.9 million that quarter, which came out to a loss per share of $1.56.

Cineplex's Q2 current ratio is 0.1 times, down from 0.4 times against Q2 2019. Combined with negative cash flows, this means there's greater risk that it could run out of money, unless it gets subsidized.

What's the risk and reward?

In the worst-case scenario, Cineplex can go bankrupt. However, simultaneously, the stock can more than triple your money if it survives this pandemic.

Currently, analysts have an average 12-month price target of $13.70 per share on the stock, which represents near-term upside potential of 188%.

However, if it survives through this black swan event, you can be sure that analysts will lift its price target. Oh, and its dividend will also be at least partially restored.

The Foolish takeaway

The risk in Cineplex's business has once again heightened, as it's threatened with another possible round of theatre closures. If so, most of its already pandemic-driven reduced revenues will vanish, and it will for sure post another quarter of loss. That's why the stock fell 29% yesterday.

Investors who are betting on the stock now should have an exit strategy. They should either consider selling the stock on pops or hold the stock for a few years if they're eyeing for that multi-bagger.

In either case, don't bet the farm, as it is a high-risk investment that can lose your entire bet.

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