Stock Market Crash: Is Cineplex Stock Now Oversold?

Description

The theatre sector is among the hardest-hit due to the pandemic. This has investors with a contrarian strategy wondering if **Cineplex** (TSX:CGX) stock is getting too cheap to ignore.

Why Cineplex's stock price continues to slide

Cineplex's share price is down 85% in 2020.

The stock used to be a no-brainer pick for dividend investors to get steady and growing distributions. Despite rising ticket prices, people always flocked to the big-screen venues to catch the latest blockbuster movie and gobble up mountains of high-margin popcorn, soda, and sweets.

Although the plunge in Cineplex's stock price might feel sudden, the writing was on the wall for some time.

Why?

Advancements in broadband internet technology should have been an early warning sign for Cineplex investors. Once movie streaming became reliable, it was just a matter of time before people would start to direct their entertainment budgets to home theatres.

In addition, the content producers knew they could potentially bypass the theatres altogether, once subscriber growth hit a certain level.

The arrival of the pandemic in 2020 hastened the demise of Cineplex's business model. Lockdowns forced the closure of theatres. This led people who would normally go to the movies to sign up for additional streaming services. The past 12 months saw the launch of several new choices in the streaming sector, putting additional pressure on the theatres as content choices expanded.

To make matters worse for Cineplex and its stockholders, the pandemic provided studios with the opportunity to test the waters on direct-to-streaming releases. Previously, they might have feared missing out on big revenue opportunities at the theatres. The opportunity cost of going straight to subscribers fell significantly in recent months.

Disney, for example, decided to skip theatres and released *Mulan* on its new streaming service.

Studios that do not have streaming options are delaying the release of new big-budget films. Without popular films to show, it doesn't matter if theatres have reopened. The impact became evident this week when U.K.-based **Cineworld** decided to temporarily close its U.S. and U.K. theatres.

This announcement led to a new plunge in Cineplex stock that saw the share price dip below $5.

Is Cineplex a contrarian buy now?

Rising coronavirus cases in Canada's largest urban centres pose new lockdown risks. Cineplex is already struggling with capacity restrictions in the theatres that are open. Additional reductions in the number of people allowed in the building, or new closure orders would put added pressure on the stock.

The decision by Cineworld to close its operations will likely result in more film releases being delayed until 2021. There is a good chance things will not return to normal until the second half of next year, once COVID-19 vaccines become widely available.

Cineplex might be forced to follow the lead of Cineworld to preserve cash. This would be another negative for the stock.

Given all the uncertainty, investors should be careful trying to catch the bottom.

Upside?

The share price is now so low that contrarian investors might want to consider a bet on a takeover. Cineworld had agreed to buy Cineplex for north of $30 per share late last year. The pandemic killed the deal, but it gives investors a sense of the value of the business in normal times.

A buyer with lots of cash could take advantage of the current situation. One of the streaming giants might see an opportunity to own the big-screen venues to showcase popular films and leverage relationships with subscribers. They only need to ride out the downturn through the first half of 2021.

At that point, studios will release films again and people should return to the theatres. Pundits say there will always be demand for the big-screen experience.

I wouldn't back up the truck, as this stock could go much lower in the near term. However, Cineplex is starting to look very cheap and a bounce back to $10 is certainly possible on new takeover interest.

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