Cineplex (TSX:CGX) Can't Survive a Second Wave

Description

Few Canadian stocks have done worse in 2020 than **Cineplex** (TSX:CGX). Down 86% year to date, it's been hit harder than even **Air Canada**. The reasons for the beating aren't too hard to understand. To aid with social distancing early in the COVID-19 pandemic, a number of provinces shut down movie theaters. That persisted for the early months of the outbreak.

Later, many provinces allowed theatres to re-open. But in Ontario, that's been reversed. If a second wave of COVID-19 makes it to other provinces, that could force Cineplex to shut down all of its theatres nation-wide. If that happens, it may not be able to survive long term.

Operations virtually shut down

In the early months of the COVID-19 pandemic, Cineplex was virtually shut down. According to its second quarter report, the company shut down *all* of its theatres on March 16. Later, it was able to re-open many of them. But earlier this month, Ontario ordered them to shut down again, citing a rise in COVID-19 cases. If cases start rising in more provinces, then Cineplex will lose significant sums of money.

Earnings take a dive

In the second quarter, Cineplex lost $98.9 million on revenue of $22 million. That's a loss more than 400% of revenue. A company can't sustain losses that severe for long without either borrowing or draining their existing liquidity. It looks possible that Cineplex's Q3 loss could be less severe than its Q2 loss because it was able to re-open some theatres as the first wave fizzled out. But as mentioned above, the company will be right back where it started if a second wave goes nation-wide.

Liquidity taking a hit

If a company has a lot of liquidity then it can survive an earnings decline. Unfortunately, Cineplex is rapidly burning through its available liquidity. At the end of 2019, CGX had $26 million in cash and equivalents. By the Q2 2020, it was down to $13.5 million. It looks like this company is chewing through cash reserves just to pay fixed costs.

On the bright side, the company has managed to reduce its variable costs. For example, it managed to reduce payroll costs from $41 million to $200,000. But fixed costs are high enough to cause serious financial damage.

No more dividends

A final sign that Cineplex is facing a dire situation is the fact that it has suspended its dividend. When a company is known for paying a dividend and then eliminates it, the market typically reacts extremely negatively. For this reason, managements are reticent to cut dividends when it can be avoided. The fact that Cineplex cut out its dividend entirely is a bad sign. It indicates that management believes they're in for serious financial pain.

If they only thought mild damage was coming, they might lower the dividend, but they wouldn't cut it out entirely. So it looks like Cineplex management believes there is more pain to come. That will certainly be the case if Ontario's second wave goes nation-wide.

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