Why Cineplex (TSX:CGX) Stock Fell 10% Yesterday

Description

Cineplex (TSX:CGX) stock continued its downward slide yesterday, as the second wave of the coronavirus escalated. With this, the possibility of more theatre shutdowns looms. It's no wonder that this contrarian stock is down 85% in 2020 and down big again yesterday.

So, let's look at why Cineplex stock was down 10% yesterday to determine if this contrarian stock is a stock to buy.

Cineplex before the pandemic

First, let's review where Cineplex was before the pandemic hit. It was a pretty rosy picture that, in hindsight, we can fully appreciate. Because at the time, too many investors were focused on the threats that Cineplex faced. There was a lack of appreciation for the strength of the business.

Cineplex generated revenue of $1.7 billion in 2019, 3.3% higher than the prior year. This was accompanied by a significant rise in cash from operations to $321 million. Cineplex continued to show strength in the first two months of 2020 as well. Revenue during this time increased 6%.

And the company was getting noticed globally. The Cineworld acquisition is evidence of this. The deal valued Cineplex stock at $34 in December 2019. When the pandemic hit, Cineworld backed out of this merger. But this is not a reflection of Cineplex the company but rather of the macro environment.

Cineplex stock tanks as closures hit hard

Cineplex theatres and playrooms were closed for almost the entire second quarter. During this time, Cineplex focused on its long-term sustainability. Operating costs were reduced, especially lease costs and payroll costs. This, along with a renewed focus on other areas of its business, allowed Cineplex to reduce its cash burn.

After slowly reopening its theatre in the summer, provincial governments are mandating that theatres once again close in certain hotspots. Coronavirus cases continue to rise nationwide, so even more closures are probably coming.

The company's diversification efforts over the last few years are a buffer — a small buffer, but a buffer nonetheless. Digital media, food delivery, and Cineplex Store are some bright spots today. For example, Cineplex Store continues to grow. It is achieving a 32% growth rate in customers.

Cineplex regroups and refocuses

22 of Cineplex's 68 theatres are closed in the virus hotspot regions today. The risk of more shutdowns remains and as the virus numbers escalate, this becomes increasingly likely. But the question is whether Cineplex is able to withstand this or not.

As discussed, Cineplex has worked hard on cost cutting. Liquidity has been of utmost importance. Management slashed costs to maintain liquidity. Cineplex also raised more than $300 million in convertible unsecured debt in July. And the company is only 51% drawn on its credit facility. In a nutshell, Cineplex's cash position has increased substantially and it has ample credit available to draw upon.

Cineplex's cash burn now stands at $18 million per month. The company has received government subsidies and has negotiated reduced lease payments and a cessation of certain contracts. Interestingly, Cineplex is slightly cash flow positive at theatres that are open. This is the case, despite the fact that they are operating at significantly reduced capacity levels. Cineplex management's goal is to weather the storm while maintaining its long-term strategy and sustainability.

Motley Fool: The bottom line

Cineplex stock remains a high risk/high reward proposition for investors. But as this contrarian stock continues its descent due to the risk of closures, the company has shored up its liquidity. The goal is short-term survival beyond the coronavirus pandemic. In the long term, Cineplex stock can offer investors sky-high returns when things return to some kind of normalcy.

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