Why Cineplex (TSX:CGX) Stock Remains a Risky Investment

Description

Vaccine-related news and post-pandemic recovery hopes have notably boosted re-opening plays since last year. Re-opening stocks have soared almost 110%, while TSX stocks at large are up just 30% in the last 12 months. One of the popular names among them is **Cineplex** (TSX:CGX). The theatre chain operator stock has soared almost 200% since the vaccine launch in October last year. But will it continue to delight investors in the long term?

Cineplex: Q1 2021 earnings

Cineplex reported its Q1 2021 earnings much on the expected lines. Its revenues during the quarter came in at $33 million — a sizeable drop of 85% year over year. This was the fourth consecutive quarter for the company where its top line fell by more than 85% or more. Cineplex posted a net loss of $89.7 million for the quarter ended March 2021.

However, the worst part is not its revenues or earnings dent. The bigger concern is its fast-deteriorating liquidity position. With mobility restrictions and closures in place, Cineplex is bleeding cash at a rapid pace. It burnt $80.5 million cash in Q1 2021, the highest since last year, compared to $74.3 million in Q4 2020. Notably, the company had a cash balance of a mere $19.5 million at the end of March 2021.

Cineplex has done a flurry of remedies to plug its cash spill in the last few months, from dividend suspensions to selling and leasing back its head office building. However, none of the cures have worked meaningfully, and its liquidity position has worsened.

Risks and challenges

Investors should note that things have not changed in Q2 2021 on the restrictions front. So, one can expect another quarter of financial dent and cash burn from Cineplex. In the last 12 months, it has booked $540 million in net loss, which is equivalent to previous six years of profits.

Faster vaccinations and a gradual release of restrictions could change the fate of Cineplex, though. The footfall should gradually increase and will help the company lower its cash burn.

However, the positive impact of this will likely be slower and lesser in magnitude. That's because even if a majority of the population gets vaccinated, the speed at which it can increase foot traffic in theatres will be interesting to see.

Besides, the pandemic has changed consumer behaviour significantly, which seems unlikely to reverse anytime soon. For the last more than a year, people staying at home are more used to watch movies on the OTT platforms, which could continue post-pandemic.

Valuation

Some analysts claim Cineplex as a value pick. However, the stock is currently trading at a price-to-book value ratio of 34, notably higher than its historical average.

Deteriorating liquidity position must be forcing Cineplex to raise additional capital at higher interest rates. This will likely push its profitability further, ultimately impacting shareholder returns.

I think CGX stock might trade volatile in the short term with limited upside potential. If reopening efforts stall, its balance sheet should weaken further. Meanwhile, the company might have to look for additional avenues to lower its cash burn to survive longer.

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