Cineplex (TSX:CGX) Stock Has Lots of Catching Up to Do

Description

Cineplex (TSX:CGX) stock has gone through a lot of hardships through the pandemic. Originally, U.K.-based **Cineworld** offered to buy Cineplex for $2.8 billion, which drove CGX stock up approximately 36% from $25 to $34 per share in late 2019. Then the pandemic hit, and the deal was called off.

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During the pandemic, Cineplex's theatres and recreation locations were forced to shut down due to economic lockdowns. As a result, its revenues tumbled. In the last 12 months, Cineplex only managed to recognize about $177 million of revenues, which was 1% of its 2019 revenues!

The pandemic is probably the worst black swan that has hit the company in its history. Because of this, the company's fundamentals deteriorated quickly. The management has to tread the waters with high precaution.

Cineplex stock has lots of catching up to do, including turning a profit, improving the balance sheet, and recovering the stock price.

Turning a profit

What's needed first is the restoration of revenue. Without revenue, there would be no earnings and cash flow.

Vaccine rollouts are happening across the country. Successive economic reopenings should boost Cineplex's revenues, especially compared with last year's horrible financial results.

Assuming the 2019 numbers as normalized financial results, we can see how much catch-up room is available for Cineplex. Its Q1 2019 revenue was $364.6 million. Its Q1 2021 revenue was about 11% of that amount at $41.4 million. Its Q1 2019 (earnings before interest, taxes, depreciation, and amortization) EBITDA was $42.2 million. Its Q1 2021 EBITDA was -$53.8 million.

After accounting for interest expenses and taxes, the loss is even worse! The company has been operating at a loss since Q1 2020 for a cumulative net loss of $718.6 million through Q1 2021.

It would be more accurate to use the full year's financial results, but currently, only Q1 2021 results are available. Based on Q1 2019 and Q1 2021 comparisons, there's about eight times the room for revenue improvement. This assumes that theatregoers haven't changed their habits of consuming movie content. It's more likely that a percentage of customers have converted to other forms of entertainment.

Improving the balance sheet

Because of the huge reduction in revenue, which led to the subsequent massive net losses discussed earlier, Cineplex's balance sheet is in a dire situation.

The company ended Q1 2021 with total debt to total assets of 102.9%, which means if the business were to liquidate tomorrow, shareholders would get nothing. Its interest and debt coverage ratios were also in the negative.

In February, Cineplex raised $250 million from a notes offering, which bears an interest rate of 7.5% per year through February 2026. That is a high interest rate given today's low interest rate environment and signifies how risky an investment in Cineplex is.

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Management really needs to get their acts together to boost revenues by attracting customers to its locations as soon as economic reopenings permit!

Recovering the stock price

Interestingly, Cineplex stock fell to as low as $5 per share in late 2020. Since then, the high-risk stock has tripled to the $15 level, as investors became increasingly optimistic about economic reopenings.

Surely, CGX stock has a nice upside potential of more than 60% to return to the $25 level. However, extremely high risk and high uncertainty remain in the business.

The Foolish investor takeaway

Currently, Cineplex stock is a speculative turnaround investment at best. Investors should instead highly consider investing in better businesses that have growing revenues, rising earnings or cash flows, and solid balance sheets.

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