Cineplex Stock: A Massive Growth Opportunity or a Trap?

Description

Canada's leading theatre chain company **Cineplex** (TSX:CGX) saw its shares tumble to 30-month lows early this month. However, the stock quickly recovered from those lower levels, thanks to a couple of bullish brokerage reports. CGX stock has lost 30% this year, notably underperforming broader markets.

CGX stock: Is it a good buy or a high-risk bet?

The post-pandemic demand recovery is a key to Cineplex's upturn. And we have started seeing some early signs of that in the last few months, though with some hiccups. Still, some brokerage houses are encouraged by the prospects of consistent normal operations. That will likely lead it to sustained profitability. Plus, blockbuster releases scheduled to release in the next few months could also drive its top line higher.

So far in 2022, Cineplex reported total revenues of $579 million, a jaw-dropping increase of 446% compared to the same period last year. It posted a net loss of $40 million in the first half of this year. Even if the loss has narrowed recently, unstable profitability could concern investors.

Unstable profitability and a large debt pile

Apart from profitability, Cineplex's balance sheet could also bother investors. It has $1.8 billion in total debt and a debt-to-EBITDA (earnings before interest, taxes, depreciation, and amortization) ratio of six as of June 30, 2022. The debt-servicing costs have notably increased while operating profits have dwindled since the pandemic. However, higher expected revenues and operating efficiencies could positively change the picture.

Moreover, what could substantially change Cineplex's balance sheet is the settlement amount it is expected to receive from **Cineworld**. In 2020, Cineworld walked away from its proposed takeover offer amid the pandemic.

As a result, the Toronto court ordered Cineworld to pay $1.24 billion to Cineplex in damages. However, the payment is yet to be made, and now Cineworld has filed for bankruptcy. So, there is now a significant amount of uncertainty about when the payment will be made in full.

A settlement with Cineworld could significantly change Cineplex's prospects.

If Cineplex receives the said amount soon, it will substantially strengthen its balance sheet. The settlement amount is almost half of its enterprise value. So, a quicker resolution should improve its balance sheet — a significant positive for investors. Moreover, consistent profitability, given the increasing foot traffic at movies, will likely create notable shareholder value.

On the flip side, two factors could delay the recovery and push the stock to lower levels. First is an impending recession. A longer, severe recession could dent discretionary spending, ultimately weighing on Cineplex's top line. So, the trend we are seeing now will reverse in that case, leading to cash burn and pressure on its balance sheet. A second blow, then, could be a delayed settlement from Cineworld.

Bottom line

Given the uncertainties, CGX stock will likely continue to trade more volatile than usual. But if you are an aggressive investor and are okay with its large stock price swings, CGX presents superior upside potential for the next few years.

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