Has Cineplex (TSX:CGX) Stock Finally Bottomed Out?

Description

The entertainment sector has had a rough few years. The pandemic shut cinemas down, and now the upcoming recession threatens the box office. Unsurprisingly, theatre stocks like **Cineplex** (TSX:CGX) have been drifting lower during this bear market. The stock has lost 40.4% of its value over the past 12 months. Has it finally bottomed? Here's a closer look.

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Challenges

Debt was the biggest challenge for Cineplex in recent years. As the pandemic erased the company's top line, debt ballooned to $6 billion last year. In 2022, the company's estimated debt-servicing cost was $120 million, while the core business was losing money.

However, some of these factors seem to have been resolved in recent months.

Recent tailwinds

The biggest game changer for Cineplex is its victory in the lawsuit against **Cineworld**. A Toronto court has ordered Cineworld to pay Cineplex $1.2 billion in damages for reneging on its acquisition deal in 2020. The settlement covers 70% of Cineplex's total debt.

Meanwhile, the box office is thriving. James Cameron's *Avatar: The Way of Water* is already the seventh-highest grossing movie of all time. It is estimated to generate US$2.6 billion (CA$3.5 billion) in gross revenue by the end of its theatrical run. This means cinemas have fully recovered from the aftermath of the pandemic.

Another tailwind is the company's unconventional distribution deal with studio giant Lionsgate. Cineplex will distribute the studio's 11 upcoming releases, including *John Wick: Chapter 4*, across Canada. This strategic partnership could add more value for Cineplex shareholders in 2023.

The company also swung to a quarterly net profit in mid-2022 for the first time since the pandemic. Put simply, Cineplex is slowly but surely turning things around.

Valuation

Cineplex stock is down 40.4% over the past year. It's now worth just $506 million. Meanwhile, it generated $657 million in revenue last year and could be on track to exceed $700 million in revenue this year.

According to the latest quarterly report, Cineplex also generated free cash flow per share of $0.026 in the first nine months of 2022. Assuming they can deliver $0.5 in earnings per share (roughly in line with its 2019 earnings), the stock is trading at a price-to-earnings ratio of 16. That seems reasonable for a company that's turning things around and delivering free cash flow again.

Bottom line

Cineplex has had a rough few years. Even the meme stock era couldn't rescue the company. Now, however, things seem to have stabilized. The court settlement allows the company to tackle its debt burden while recovering box office sales expand its top line.

The stock isn't undervalued. In fact, if the settlement transfer is delayed it could be a bull trap. But if the stars align, Cineplex could deliver reasonable gains for shareholders in 2023. Keep an eye on this turnaround story.

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