Don’t Be Tricked by This Company’s 4.4% Dividend: Capital Appreciation Matters

Description

In the equities space, any time an investor can find a stock yielding 4.4%, consideration should certainly be given for investors willing to buy the dip and wait for the eventual rebound in the underlying business or sector. I’m going to discuss a few reasons why I believe the long-term headwinds for a company such as **Cineplex Inc.** (TSX:CGX) may outweigh the near-term benefits.

Why capital appreciation matters

I’ll be the first one to say, I’m all for buying on dips and taking a juicy dividend, while waiting for a stock to rebound; after all, such a strategy is the meat and potatoes of most successful long-term value investors. Dividend income compensates for a significant portion of the downside a stock may provide, and with a company like Cineplex offering a yield well in excess of 4% (and compounded monthly), I have to agree that the situation remains very tempting for most investors.

That said, capital appreciation always matters. Whether you’re an investor just starting out or one heading into the golden years of retirement, a large devaluation of a significant portfolio holding will hurt for a number of reasons.

The most obvious reason is that such a hit will inevitably reduce the underlying holdings available to an investor; in a situation where an investor needs to divest of a percentage of one’s assets to fund a life event, significant stock price depreciation can act as a double-edged sword, further reducing one’s income streams, while simultaneously inhibiting the ability to compound returns over long periods of time, given the reduced book value of one’s holdings. For those investors buying stocks on margins, the situation can become infinitely worse; it is safe to say, stocks with significant long-term downside should be avoided.

The bear case for Cineplex

In the past, I’ve discussed why I believe Cineplex remains overvalued, despite its large drop, and why this company remains a value trap for investors considering adding a stake or adding to a position at the company’s current stock price level.

For those believers in the robustness and long-term earnings power of the cinema/entertainment industry, I've suggested investors consider Cineplex's American counterpart **Cinemark Holdings, Inc.** (NYSE:CNK), a company with a similarly strong dividend and stronger underlying fundamentals.

Bottom line

The fact that box office numbers have continuously deteriorated in recent quarters has indicated to me that this recent trend in the cinema space may be a protracted one; as with other once-staple industries, which fell folly to the rise of technology, I expect the entertainment-at-home option may become just attractive enough to begin to really affect the underlying fundamentals and earnings quality of firms such as Cineplex.

To be safe, I suggest investors look at better value options available in North America at this time.

Stay Foolish, my friends.

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