



Watch Out for This Dividend Value Trap: Cineplex Inc. Remains Significantly Overvalued

Description

Of all the companies on the TSX offering investors what would appear to be [excellent value](#) (a large dip of more than 38% from its 52-week high, well-covered by fellow Fool contributor Joey Frenette), I continue to have issue with **Cineplex Inc.'s** ([TSX:CGX](#)) balance sheet and the long-term prospects for Cineplex's operating business in supporting its legacy cash demands for shareholders.

While many believe that Cineplex' dividend and share repurchases to be safe, I would argue that at current spending levels, the company will be forced to decide to cut its dividend, or alternatively, raise its debt or equity to cover dividend payments in the absence of immediate growth — scenarios that are equally unappealing to long-term investors hoping to pick up a value play offering a 5% yield.

Dividend unsustainable given current cash needs

According to the company's most recent financial statements, the gap between current liabilities and current assets reflected in a current ratio of 0.53 has been identified as a problem Cineplex intends to solve by utilizing its credit facility: "Cineplex believes that it will be able to meet its future cash obligations with its cash and cash equivalents, cash flows from operations, and funds available under the Credit Facilities as described in Section 6.4, Credit Facilities."

This past quarter, the company has been forced to borrow more than \$35 million over the same quarter last year from its Credit Facilities, an increase that roughly covers the dividend payments and share repurchases made during the quarter.

Year-to-date, Cineplex's borrowing from its Credit Facilities has increased by more than \$83 million to \$191 million per year, a significant amount when compared to the company's overall revenues. Cineplex has used up all of its smaller \$150-million term facility, and has only \$127 million remaining on a larger \$475-million secondary facility (\$348 million drawn or reserved), meaning that Cineplex is set to run out of cash paying its dividend within two quarters or so at its current cash burn rate.

Bottom line

Cineplex will need to either reduce its cash burn rate, increase its operating cash flow, or increase its cash flow by issuing more debt or more shares within the next six months in order to maintain its dividend. No matter what the scenario, the company is currently unable to support its dividend with operating cash flow alone, and is running out of time to figure out how to go about maintaining a yield of approximately 5%.

Year-to-date double-digit decreases in Net Income, Adjusted Free Cash Flow, Earnings per Share (EPS) Basic, and EPS Diluted resulting from poor attendance (-7%), partially offset by rising revenues from increased prices have indicated that we are now entering a cycle in which raising prices marginally cannot recover the negative earnings and cash flow effects that reduced attendance is likely to have on the company's balance sheet over the long term.

Home entertainment options are only just beginning to [eat away](#) at Cineplex's long-term cash flow generation abilities, making this company a dangerous dividend value trap for long-term investors.

Stay Foolish, my friends.

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