This High-Yield Dividend Grower Should Cut its Dividend Pronto

Description

Cineplex Inc. (TSX:CGX) has fallen into limbo. If you followed my sell recommendations, you would have saved yourself a great deal of pain, as shares are now down nearly 40% from peak to trough. Despite the massive plunge, Cineplex shares still trade at a premium growth multiple with a 32.74 trailing price-to-earnings multiple. That's really expensive for what seems to be a business that's suffering from a bad case of stagnated growth … or is it?

The company has made significant moves to diversify away from the traditional movie-and-popcorn business. One could argue that the growth valuation is warranted when you consider Cineplex as a general entertainment company which could have the opportunity to benefit from becoming a major part of the shopping malls of the future.

There's only one thing that bothers me at these levels though; the medium-term outlook for Cineplex and movie theatres in general is bleak, and Cineplex's diversification into general entertainment is going to take years. If Cineplex really is a growth business that's worthy of the premium multiple, it should scrap its dividend and focus all of its efforts on further diversifying its portfolio of entertainment offers.

Why Cineplex should cut its dividend

Cineplex shares currently offer a bountiful dividend yield of ~5%, and many income investors may be wondering if it's an attractive high-yield growth stock that they should be including in their portfolios.

Cineplex has a shareholder-friendly management team. The dividend has grown on a consistent basis and hasn't been cut over the past decade. While that may seem like good news to investors, I actually think it's bad news for contrarians looking for Cineplex to rebound, as I believe Cineplex's payout ratio will continue to get stretched over the next few years, as heavily indebted Canadians opt to pass on the $20 candy-and-popcorn combo to go with their $25 UltraAVX theatre tickets. That's an expensive date night, and it's simply not worth it when you can "**Netflix** and Chill" for a fraction of the price!

Over the medium term, I believe Cineplex will run into a brick wall with its box office and concession segments, which will be exacerbated by lacklustre movie releases and straight-to-stream offerings, which will give Canadians even less of a reason to spend money on a night out at the movies.

That means the payout ratio, currently at ~160%, will soar, and I don't see how Cineplex can lower it without spending a great deal on its entertainment expansion initiatives.

I think Cineplex should do everyone a favour and cut the dividend now and go all-in with its entertainment diversification efforts. The revamped Playdium, I believe, will be a hit, but the roll-out is going to take a lot longer than expected and probably won't save Cineplex from another year of dwindling movie ticket sales.

Management needs to roll up its sleeves and put all of its resources into acquiring and expanding its portfolio of entertainment options as consumer demands continue to change over the next few years. Millennials clearly prefer experiences over materialistic goods, so there's a huge window of opportunity to become a growth king again.

Unfortunately, I think Cineplex will keep its dividend intact for as long as it's able to, as it takes a page out of the book of **Corus Entertainment Inc.** — a falling knife with a management team that has refused to cut its dividend, even though the cash could be put to much better use.

Bottom line

My view on Cineplex remains the same: income investors and retirees should avoid Cineplex for now, but aggressive contrarians and bottom fishers may wish to accumulate shares on the way down. I'm staying away from the stock until the dividend is cut and more light is shed on its long-term growth strategy.

Sadly, I don't think the dividend will be cut anytime soon, because Cineplex will try to juggle growth initiatives while maintaining a high payout to keep its remaining income investors content.

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Date
2025/08/20
Date Created
2018/01/15
Author
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