



Forget Cineplex Inc.'s Payout Ratio: Consider its Free Cash Flow Generation

Description

Heading into 2018, **Cineplex Inc.** ([TSX:CGX](#)) investors are sure hoping for a rebound following what can only be categorized as a dismal 2017. Shares of Cineplex are currently down approximately 40% from just one year ago, and what was expected to be a stronger third and fourth quarter for the company's cinema business actually turned out to be less than impressive, bolstering investor pessimism, as investors wait for some sort of positive data stemming from upcoming blockbusters (which appear to be few and far between).

Fellow Fool contributor Ryan Goldman recently covered the company's [payout ratio](#), suggesting that Cineplex may be forced to cut its dividend, unless its financial situation improves. While I tend to agree that Cineplex has grown its dividend at a rate which has simply not been proportional to earnings over the years, Cineplex has shown a tendency to maintain a sky-high payout ratio in the past, making a dividend cut less of a likelihood based on payout ratio alone. See the chart below.

Year	Payout Ratio
2008	226%
2009	133%
2010	114%
2011	133%
2012	68%
2013	91%
2014	144%
2015	109%
2016	76%
TTM	160%

That being said, paying a high yield at the detriment of paying down debt or investing in efficiency-generating activities (rather than overpriced acquisitions) should be the focus of Cineplex's management team, and in that regard, Mr. Goldsman has a point.

Looking past Cineplex's payout ratio for a second, I would like to take some time to discuss why the company's free cash flow generation, currently at 10-year lows, is the real culprit for why the company's share price should drop in the medium to long term.

Taking a look at the trend for Cineplex over the past 10 years, using free cash flow generation as a proxy for value creation, the company's management team appears to be doing a worse job at providing value to shareholders, at least in recent years:

Year	Free Cash Flow
2007	\$108 million
2008	\$80 million
2009	\$135 million
2010	\$90 million
2011	\$116 million
2012	\$107 million
2013	\$162 million
2014	\$70 million
2015	\$134 million
2016	\$60 million
TTM	\$10 million

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Whether this lack of value creation is a direct result of acquisitions, which I have argued in the past were overpriced and did not diversify the company enough in its bid to become a truly [21st century entertainment company](#), I believe Cineplex has a long way to go to create a company which will be able to provide profitable growth in the long term. Major investments are necessary in the company's weak online offering, and, in my opinion, Cineplex is missing out on some pretty amazing opportunities to provide Canadians with movie content online for a range of movies that streaming services may not want to offer Canadians (but are offered in the U.S.).

Stay Foolish, my friends.

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