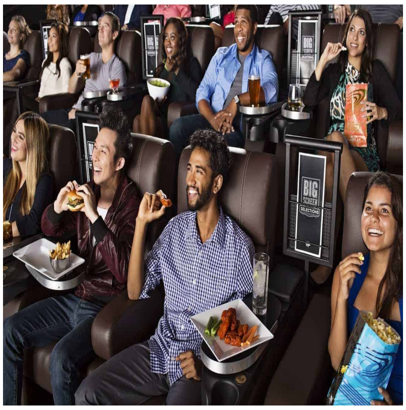

Dividend Raise Does Little to Ease Growing Concerns

Description

Cineplex Inc. (TSX:CGX), Canada's largest theatre and entertainment company, released its first-quarter results on Wednesday. One of the key points of interest for investors is the company's dividend. Historically, the company has raised dividends along with its first-quarter results in May. A rising payout ratio and decreasing cash flows has led many to wonder whether the company can sustain its current dividend.

Questionable dividend raise

The good news for dividend growth investors is that Cineplex did in fact announce a dividend raise. It bumped dividends by 3.6% for a new monthly dividend of $0.145/share. The company is a Canadian Dividend Aristocrat and has now raised dividends for eight consecutive years. However, I question that decision. If management's concern was its status as an Aristocrat and its dividend growth streak, it had plenty of time to raise dividends.

The company's earnings dropped 35% from the first quarter of 2017; with the new dividend, its payout ratio is now 180%. This is the highest dividend payout ratio in its history. Granted, a payout ratio as a percentage of earnings can be somewhat misleading. It takes into account non-cash items, which have no impact on a company's ability to pay its dividend. Cash flow is a much better metric to use. Unfortunately, it doesn't look any better for Cineplex.

In one of my previous articles, I pointed to one of the main concerns being that dividends are eating up a greater percentage of cash flow; that trend continues. In the first quarter, adjusted free cash flow dropped 10.9%. On a trailing 12-month basis, dividends accounted for 72.6% of free cash flow, up from 66.1% in the previous 12 months. This is not sustainable over the long term, however.

Disappointing box office

Perhaps the greatest concern for investors is the disappointing box office numbers. Box officerevenues decreased 7.2% from the prior year, which was helped by a 2.9% increase in revenue perpatron. Most concerning is that attendance dropped almost 10% in the first quarter in spite of record-breaking performances from *Black Panther* and *Jumanji.*

Cineplex's poor performance is magnified by the fact that it significantly underperformed the North American box office. In March of 2018, the yearly North American box office was down 2%, and attendance dropped 6% over the previous year. As you can see, the Canadian market's box office struggles is more pronounced based on Cineplex's first-quarter results.

Cineplex is a hold

Its first-quarter results came in softer than I had expected. Although the dividend raise is a welcomed surprise, I still question whether it was the right move. However, it isn't all bad, as the company does have a solid future. It continues to execute on its diversification plans and announced its intention to find annualized cost savings of approximately $25 million. *Avengers: Infinity War* is shattering box office records, and the box office looks strong over the next few months. But is it enough? At current prices, the company looks expensive and is a hold.

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