Why a Dividend Cut Could Be Good for Corus Entertainment Inc. (TSX:CJR.B)

Description

Corus Entertainment Inc. (TSX:CJR.B) has had a rough year in 2018 with its share price losing more than half of its value in the first six months of the year. Recently, the company reported a disappointing quarter that saw a big loss accompanied with a cut to its dividend, which sent the troubled stock into an even further decline.

While the company didn't need to slash its payouts as significantly as it did, the reduction in dividends will allow Corus to free up cash and strengthen its financials at a time when investors are growing concerned with the company's business model. With a dividend yield of nearly 20%, few could fault the company for bringing its payout down to a more modest level.

A dividend cut is not a good sign, since it suggests the company may be in trouble and that it needs to free up cash. However, I'm not convinced that's the case with Corus, given that the company has generated $325 million in free cash over the past 12 months, giving it a lot of capital to invest in itself or to bring down its debt load, which is what it plans to do with the extra cash.

Why a dividend cut can be a good thing

There's no shortage of negative connotations associated with a dividend cut, but there are also some very positive things that can come out of a company slashing its payouts.

The first is that it allows the company to strengthen its financials. In the case of Corus, the company can work on reducing its debt, which is currently 1.28 times its equity, and that's a bit high for what value investors would normally look for.

Debt can be burdensome since it can restrict what a company can do with its cash, given that it has to allocate a certain amount of money for interest payments, not unlike how consumer debt can hamper individual spending.

The second reason is that a company like Corus that had an abnormally high dividend yield attracted a lot of interest for the wrong reasons. When investors see dividend yields north of 5%, it's only a matter of time before questions about payout ratio and sustainability follow. With a yield of over 15%, those questions became automatic when talking about Corus.

With the dividend now at a more normal percentage, it can allow investors to focus on other aspects of the company's business, including its strong fundamentals and the growth opportunities that it has.

Bottom line

Although Corus had a disappointing earnings result, it's still not a bad investment. In fact, the stock now trades at even more of a discount and is an even better buy today. While the dividend is not astronomical anymore, investors can still earn a good return from the capital appreciation that will likely be earned from holding the stock over a long period of time.

With its business model still strong, and the company hitting a bit of a hiccup, it could be a great time for opportunistic investors to scoop up the stock at a great price.

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