Approach This 6%-Yielding Stock With Caution

Description

It's been a frustrating year for **Cineplex** (TSX:CGX) shareholders. The company's shares have done nothing but go down for months now, leaving many investors shaking in their boots. Part of the problem was the quarterly numbers, which were not fantastic. Given the cyclical nature of the movie industry, though, using the year-to-date numbers are probably a more accurate indicator of the company's overall health.

Cineplex's Q3 results were mixed. Year-to-date total revenues increased 5.1% over the same period of last year, although attendance was down 1.1% as compared to the year-to-date results from last year. Net income was up 19.8% so far this year, and adjusted free cash flow improved 19.6%. Year to date, things don't appear to be going too badly.

One of the most attractive aspects of the stock is the dividend. Sitting at a yield of around 6.59% at the current share price, the payout is beginning to look very attractive. Cineplex has also been growing that dividend consistently over the years, so if things turn around, that dividend may get even bigger as the years go on.

Unfortunately, there are many factors that make this stock quite risky. The first is the customer base. With the frustrating quality of movies being released, it's hard to believe that viewership hasn't been challenged. There is also the situation with the Cineplex's debt. While most of the money has been spent on growth initiatives, this company has nevertheless borrowed a lot of money.

Some of these growth initiatives have generated much of the company's growth over the past year. The company has engaged in a variety of novel initiatives that are paying off. Amusement services such as The Rec Room, eSports, and its partnership with VRstudios Inc., a virtual reality entertainment provider, has helped Cineplex expand its revenue streams from traditional movie theatre management. In the future, these new high-growth initiatives could become a major driver of its growth.

The extra strain on its balance sheet might make it more susceptible to an economic slowdown, potentially putting pressure on dividend growth or even the viability of the dividend itself. Cineplex is very tempting at this price level. The dividend is extremely attractive at these prices. It is a virtual monopoly in Canada, with very little competition. It has a national presence and provides a variety of entertainment services.

Cineplex's business is also dependent on the strength of the economy. If you believe that there is going to be an economic downturn in the near future, it is hard to fathom that Cineplex will not be negatively affected. Even now, with so many Canadians handling high levels of debt, it is easy to speculate that Canadians will cut back on unessential activities. Going to the movies, especially in this day and age when it is easy to watch movies over the internet, will more than likely be one of the first extravagances that are cut.

Right now, Cineplex is a speculative buy at best. The dividend is quite compelling, especially if it continues to grow at the current rate. The growth drivers, especially the Rec Rooms and eSport entertainment venues, probably have a long period of growth ahead of them. But its debt levels and a potential slowdown of the Canadian economy warrant caution. Risk-averse investors should probably steer clear for the time being.

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