The Cheap 7%-Yielding Dividend Stock That Everybody Is Talking About

Description

Over the past few years, **Cineplex** (TSX:CGX) has been an absolute horror show for its investors with shares plunging over 55% from peak to trough. But for those of us sitting comfortably on the sidelines, the drop has been somewhat entertaining, mostly because the dividend yield has swollen to the highest levels it's ever been after the drastic downfall.

Cineplex used to be the 3%-yielding dividend darling that could be relied on for meaningful growth, but after getting caught offside on the wrong side of a profound secular trend (the rise of stay-at-home video streaming), investors have completely reset their expectations. Investors that once relied on the name for the best of both worlds (income and capital gains), now have little to no reason to hang on to shares of a company that is poised to experience further multiple expansion as the box office drought continues.

Is the dividend safe? Is the box office drought permanent? How long before Cineplex can meaningfully dilute its dreaded box office segment? Does management have the formula to get bums back in its seats? What is Cineplex really worth given the damage done by those disruptive streamers?

These are all questions that investors have been asking themselves over the last two years, and for those who chose not to sell, despite the writing on the wall in the summer of 2017, the repercussions were severe.

In this piece, I'll attempt to answer most of the questions with the hopes of reaching a conclusion for income-hungry contrarians who've been following the company on its way down.

Is the 7% dividend even safe?

The 7% is undoubtedly the main attraction to Cineplex shares, and thus far the big dividend has proven to be a siren song that has led investors off course to their demise.

While the dividend has remained intact through its recent bout of hardships, I'm not a fan of the dividend's long-term sustainability. Cineplex still generates substantial cash flows (free cash flow surged 20% to $124 million last year), and there's plenty of support for the dividend such that I'd say the dividend is safe for the near term.

When you consider the direction that Cineplex is headed, however, it becomes clear that the dividend, although theoretically safe, would be better off cut, so that the funds could be used towards investing in the company's future — the entertainment and amusements segment.

Heck. A dividend reduction could spark a rally in shares should management note its intent to bolster its already impressive revenue-diversification efforts.

So, in short, the dividend is safe financially speaking but unsafe if management is, in fact, willing to take it to the next level with its non-theatrical growth efforts, which I think it should.

Cineplex is at a crossroads here. A dividend reduction will make it clear to investors that Cineplex is taking the path of growth, not the path of value as a stable, albeit decaying cash flow generator.

While Cineplex could undoubtedly continue supporting its dividend while betting big on its amusements business, including Rec Room, Playdium, eSports, and all the sort, I think a pivot towards full-on growth will prove to be the best course of action in the grander scheme of things.

The box office tumbleweeds may be here to stay

The tumbleweeds aren't going anywhere. In prior pieces, I've predicted that the box office bleed is just getting started and that it'll get much worse in 2019 with many big-name tech and media firms (**Disney** and **Apple**) diving into the video stream.

Streaming content is improving, and that's giving ex-movie-goers even less of an incentive to go out to the movies. Add competitive and lower streaming prices into the equation, and it's clear that Cineplex's pains have only just begun.

Is the stock a buy for the non-theatrical growth story?

Not yet. Management needs to pull some levers and surrender some gross margins to get more bums in its seats. Cineplex is very much at the mercy of its box office segment, and although progress in diversifying away from it has been promising, there's still a long way to go. As for the 7% yield, it's just not worth it.

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