Is There High Reward in This Big Dividend Stock?

Description

Cineplex (TSX:CGX) stock is trading near its 52-week and five-year low. It is a low expectation and potential high-reward investment.

The stock just increased its dividend. Combined with the stock price decline, the entertainment stock now offers a high yield of 7.7% as of writing.

Why CGX stock is down

Cineplex generates most of its revenues from the theatres. As a result, theatre attendance and a good movie slate are essential to the health of its core revenue.

For instance, in 2018, Cineplex generated total revenues of $1.6 billion, of which 72% required people to attend the theatres. Breaking it down, about 45% was box office revenue and 27% was theatre food service revenue.

Theatre attendance in 2018 was essentially flat from what it was in 2010 — specifically 69.3 million against 69 million. Optimistically, the box office revenue increased 2.4% per year on average through that period.

The company has been working vigorously to diversify its revenue stream into other areas, such as recreation rooms (The Rec Room), Topgolf, and Playdium. However, they only contribute to a small portion of total revenues compared to the behemoth amount that requires theatre attendance.

Is the big dividend safe?

After all is said and done, investors likely care a lot about the safety of Cineplex's big dividend, which is going for a whopping yield of 7.7%.

CGX's Q1 payout ratio was just under 95%, which is high because the adjusted free cash flow declined 24.6% year over year. The big cut was largely due to an item in the financing activities that recorded the principal repayments of lease obligations of $32,484 thousand. This amount was much larger than last year's amount of $832 thousand in the same quarter. For the full year 2017 and 2018, that item amounted to $3,180 thousand and $3,420 thousand, respectively, which indicates that the roughly 10 times amount in Q1 was likely a one-off event.

Indeed, the company reported the trailing-12 month payout ratio of 65% against 73% from the same period in the prior year, which shows a much more normalized payout ratio.

Cineplex wished to further establish investors' confidence by increasing the monthly dividend by 3.4% on May 21 to $0.15 per share (annualized at $1.80 per share). This marks the ninth year of consecutive dividend growth for the dividend aristocrat. Its three- and five-year dividend growth rates are 3.8% and 4.1%, respectively.

Foolish takeaway

The investment community generally has very low expectations of Cineplex, with the stock trading at a multi-year low. If there happens to be fairly good movie attendance (the company believes in a strong movie slate for the rest of the year), the beaten-up stock could very well experience a nice pop and deliver a high reward in price gains for buyers today. In the meantime, investors can also enjoy a big yield of 7.7% in the form of a monthly dividend.

Thomson Reuters has a mean 12-month target of $31.10 per share on the stock across 10 analysts. The price target represents 33% near-term upside at $23.35 per share as of writing.

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Date
2025/08/02
Date Created
2019/06/03
Author
kayng