



TFSA Investors: Why This Dividend Aristocrat Doesn't Belong in Your Portfolio

Description

Cineplex ([TSX:CGX](#)) is one of those stocks that looks less attractive the more it raises its dividend. The company hardly needs an introduction, since it's the leading theatre operator in Canada by a comfortable margin; however, this size and scale has not translated into cold, hard cash. With a yield that's almost 8%, Cineplex is just a few bad quarters away from a much-needed dividend cut.

Weak Q1 ... and probably a weak Q2

Back in May, [I wrote](#) that for the company to grow, it's got to get rid of this dividend burden. Unfortunately, management seems to be disconnected from this perspective and instead opted to increase its payout, even in the face of poor first quarter.

To recap, for Q1 of 2019, Cineplex reported more of the same industry-wide structural issues it's been facing for the past year. Theatre attendance fell by a whopping 15.6% from the prior year due to a weaker film slate, translating into box office revenues of \$156 million, or a decrease of 14% from the same period. Fewer patrons also mean less concession revenues (which is Cineplex's highest-margin business segment); Q1 saw food sales slump 12% year over year to \$95 million.

So, it appears that Q1 was a write-off, but perhaps things will look up for Q2?

Don't count on it: if we look at year to date box office revenues, 2019's spring receipts have been pretty lacklustre, and thanks to big budget bombs such as *Men in Black*, *Dark Phoenix*, and *Godzilla*, we can anticipate Q2 (which ended on June 30) to be another materially weak quarter.

Second-half box office slate looks promising, but can the company take advantage?

However, things do begin to look up for Cineplex in the second half of the year, thanks to the recent slate of live-action **Disney** remakes, and upcoming films in the *Star Wars*, *Frozen*, and *Fast & the Furious*

franchises. That being said, the current dividend is beginning to look like an obstacle, standing in the way of Cineplex benefiting from these coming tent-pole titles, as it's encroaching on funds that could go towards theatre renovations and upgrades.

Based on previous quarters, it appears that Cineplex was able to demonstrate pricing power, despite falling attendance. In 2018, the company reported revenues per patron of \$10.46, up for \$10.17 in 2017, thanks entirely to theatre renovations, which installed reclining seats and UltraAVX screens, as well as offering more premium food offerings. This is the path that I would like Cineplex to continue towards: increasing its capital spending to revitalize its brand as a source of premium entertainment and draw customers away from streaming services.

The bottom line

But for initiatives like these to be successful, Cineplex's dividend burden must go. For example, in 2019 Cineplex's free cash flow payout ratio was a whopping 108%, and even via the company's own "adjusted" free cash flow figure, the payout ratio was still over 60%. Furthermore, its term credit facility is fully drawn, and its leverage ratio is at all-time highs. With further roll-outs planned for its Rec Room sports bar brand, renovations and new auditoriums, there is little reason why Cineplex should keep its dividend, when it could free up much-needed cash for these capex plans while paying down its debt.

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