1 Stock Yielding 8% That Could Rocket Higher

Description

What is going on with the shares of **Cineplex** (TSX:CGX)? The shares have been beaten down to practically all-time lows, and the dividend is sitting at just under 8%. A high yield such as this draws my eyes, especially at a time when the yield on cash is so low. But is Cineplex worth taking the jump, or is it simply too much of a risky proposition to even attempt to take the chance?

Whenever a stock falls as hard as Cineplex has, one has to look at what is going on with the company. Part of the problem with the stock price is that it is still based upon the previous quarter's movie slate. In the Q1 report, Cineplex stated that the weak movie slate negatively impacted its overall revenues, which were down by 6.6% year over year. This did not sit well with investors, as this is a pretty significant drop.

The problem is, looking at the number at face value does not give an accurate measure of its operational ability. This number occurred during a relatively weak movie slate and was compared to the previous year, which was boosted by the enormous success of the movie *Black Panthe*r. With numbers from *Avengers: Endgame* coming in the Q2 report, there might be a huge boost in this number. This just goes to show that Cineplex's variable revenues from its theatre business are not a great gauge for overall profitability.

In order to smooth out its lumpy revenues, the company has been trying to broaden its business with a few different strategies focused on out of theatre entertainment. Even with the poor movie slate, Entertainment and Leisure segment revenues continued to grow by 17.2% to an all-time high of $58.5 million. The success of the Rec Room locations as has shown that Cineplex is able to grow even in spite of the poor movie turnout.

The growth in its Media and Entertainment and Leisure segments have begun to diversify Cineplex away from its reliance on movies. While still the majority of its revenues at 72.9%, Film Entertainment and Content has decreased from the 77.3% of revenues it represented a year earlier.

With the dividend sitting at a yield of almost 8%, many investors might be worrying that a cut might be on the horizon. However, the latest quarter provided an indication that the payout might be safer than investors realize. In the first quarter, Cineplex announced a 3.4% increase to the quarterly payout. At least for the time being, the company seems to be committed to continuing returning cash to shareholders in the form of quarterly dividends. But as fellow fool Victoria Matsepudra has written, the dividend is by no means a certainty. In my opinion, this is due to the following issues.

This is not a low-risk stock. There are two major issues facing the company: a potential recession and its relatively high debt load. In my mind, it is the recession risk that is the major threat. Cineplex is a Canadian-focused company that is very economically sensitive. If people lose jobs or, heaven forbid, their houses, the last thing they are going to spend money on is a trip to the movies.

This leads me to the debt. If a recession hits, earnings will likely decrease substantially as people give up their movie trips. In the Q1 2019 report, Cineplex indicated it had $606 million in long-term debt. The debt increased by 4.5%, which is not exactly a comforting trend. Most of the debt, though, has been spent on their two growth segments, so it may pay off in the long run.

A risky, but potentially rewarding buy

Cineplex is one of those stocks that could pay off very well or could be a disaster. If all goes well and a recession is years off, Cineplex may be able to achieve the growth to which it aspires. The dividend appears safe at the moment, and the stock has been beaten up so badly that it is worth a tentative shot.

But approach this stock with care and in small amounts. The debt remains a wildcard. I would like to see the company paying down its debt rather than increase it. Take a wild stab at Cineplex in a taxable account, so you can write off losses if needed.

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Date
2025/08/26
Date Created
2019/07/25
Author

krisknutson