Is Cineplex (TSX:CGX) Stock’s 8% Dividend Yield Sustainable?

Description

There comes a time when no matter how much or how little we believe in a company and its business prospects, we must get down to the work of establishing whether the stock’s dividend yield is sustainable. Can **Cineplex** (TSX:CGX) continue to pay its dividend? And what are the chances that it will need to be cut, which would be brutal for its stock price?

Competition in the movie business accelerates

Heightened competition in the movie business is not a new thing. The emergence of **Netflix** and Crave, along with a multitude of other streaming options, has really altered movie-watching habits and highlighted the risk to those that don’t adjust to the times.

This month, **Disney** Plus launched in Canada. For $9.99 per month, movie watchers will have access to offerings from Fox, Pixar, Marvel, and National Geographic, as well as different new original series that will be launched in the next couple of years. The offerings can be streamed on multiple devices, which is a big part of the future of movie watching.

The choices for movie watchers seem to be endless these days. But as a movie watcher, adding another $9.99 a month on your monthly bill for Disney Plus is not without its disadvantages. If we add this to cable, Netflix, Crave, and a variety of other offerings, it is clear that choices have to be made. How many monthly payments do we need or want?

It might seem like Cineplex is getting lost in this new world, with movie theatre attendance peaking and now declining, leaving investors to question the company’s very “raison d’etre.” But Cineplex is Canada’s leading diversified entertainment and media company; it has built a strong brand for itself over the years — a brand that is loved and at least well known among different target markets, such as the baby boomers, millennials, and everyone in between. It is everywhere, and it is a force to be reckoned with in everything entertainment.

It is also a business that has been generating healthy cash flows and increasing diversification away from the movie theatre exhibition business. Both of these points should help to slowly alleviate investor concerns regarding the dividend. As time marches on, the company clearly needs to continue to prove itself in these respects, but so far it looks good.

Diversification into high-growth businesses continues to progress

In the second quarter of 2019, revenue from sources other than the box office represented a full 27% of total revenue. Cineplex media revenue increased 11.4%, Cineplex digital media increased 41.3%, amusement, excluding Rec Room, increased 16.8%, and Rec Room revenue increased 36.4%. In total, revenue from sources other than the box office increased an impressive 20.9%.

We can see how this entertainment behemoth is successfully morphing from a theatre exhibition business, which is plateauing, to an entertainment company that is growing fast. If the company continues to show that it can successfully complete this transformation, investors will realize that this stock, which is currently trading at roughly 18 times 2018 earnings, is worth much more.

Cineplex has beat expectations in both quarters this year, in what may very well be a sign that expectations have gotten too low, and that more earnings beats are coming, which will result in more upward earnings revisions. In this scenario, Cineplex stock has big upside. Third-quarter results will be released on Thursday.

Foolish bottom line

The bottom line here is that the dividend is well covered by Cineplex's cash flows, which are expected to continue to strengthen as diversification efforts continue to take hold and as spending on diversification spending eases. Cineplex stock provides investors with a reliable dividend yield as well as increasing exposure to the fast-growing gaming industry to more than offset declines in its traditional business.

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