Yield Alert: This 7.7% Dividend Just Got More Secure

Description

One thing high-yield investors must always guard against is the dreaded dividend cut.

A slashed dividend doesn't just impact your income. It also sends shares reeling, as disappointed income investors hit the sell button indiscriminately. Many dividend investors have iron-clad rules that say they will give a company the benefit of the doubt until a dividend cut, and then they're out immediately. This wave of sellers undoubtedly sends the stock price spiraling lower.

On the flip side, investors who get into what looks like a potentially dangerous dividend situation can reap some impressive capital gains once the stock recovers. This leads to an ideal outcome of excess capital gains, a solid dividend, and a terrific total return. These are the kinds of results that can make or break a portfolio.

Let's look at one such stock today — a company that pays a dividend many have said is ripe to be cut. Here's why that payout just got all the more secure, which could very well lead to capital gains in the future.

Terrific results

Cineplex (TSX:CGX) came out with its third-quarter results on Thursday, and the numbers were extremely encouraging.

Let's start with the top line, which shot more than 8% higher on strength from the legacy theatre business as well as the company's forays into other areas. Cineplex's media division saw revenue up more than 10%, while its entertainment business increased the top line by more than 16% on the strength of two new The Rec Room locations opening. Even the theatre business, which hasn't posted good results of late, saw revenue up more than 2% in the quarter. This, in turn, helped increase concession revenues.

Not surprisingly, this substantial revenue increase led to attractive bottom-line results. Earnings per share increased to $0.21 — a result that was more than 20% better than the same quarter last year.

Adjusted EBITDA, EBITDA margins, and adjusted free cash flow per share also saw significant improvements.

Cineplex's SCENE program also passed an important milestone in the quarter, gaining an additional 0.2 million people to finally surpass 10 million members. Investors often forget about SCENE, one of Canada's top loyalty programs.

Looking ahead to the fourth quarter, results should continue to be strong. The company is still aggressively investing in its diversification program away from movie theatres, and the new *Star Wars* movie should drive theatre attendance.

What this means for the dividend

Many investors are nervous about Cineplex's 7.7% yield, as they think trends such as continued strength in video streaming — including the recent launch of Disney+ — will do irreparable damage to the industry.

Cineplex's recent results show the company can be strong in the face of that adversity. The movie theatre business isn't quite dead yet, folks.

These quarterly results are also good news for the security of the dividend. Based on adjusted free cash flow for the quarter, the payout ratio dipped all the way down to 59%. The payout ratio for 2019's results so far checks in at just a hair over 65%.

Stocks with payout ratios in the 60-65% range don't usually cut their dividends. In fact, I'd argue investors can now expect another dividend increase in 2020, which would mark the 10th consecutive year Cineplex has increased its dividend.

The bottom line

Thanks to these solid numbers, folks who were previously worried about Cineplex's dividend going forward can breathe a little easier. The payout is all the more secure today.

The stock looks to be pretty undervalued today, too. If it can continue to post solid results, look for shares to rebound nicely from today's levels.

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