The One Foolish Metric We Can All Be Thankful For

Description

There are many, many different ways to analyze the quality of a business. It can be overwhelming and I'm not sure about you, but I don't like being overwhelmed, even though I have 3 young girls.

On this Thanksgiving eve, I'm going to make your life a little easier. While you can pour over financial statements until you're blue in the face, there is one number that will tell you almost everything you need to know about the quality of a business.

It's called free cash flow, and you calculate it by taking cash flow from operations and subtracting capital expenditures. To arrive at such an important number, the math doesn't get much easier than that.

Simply, if a business is able to consistently generate free cash flow, there's a good chance it'll be a winner. There's an old stock trading saying that goes something like "you can't go broke taking a profit". Well, if a company consistently pumps out free cash, that company ain't going broke. And neither are you if you invest in it.

It is from free cash that dividends are paid. Stock is bought back. Growth initiatives are undertaken. A business that has free cash controls its own destiny. A business that doesn't is reliant on the kindness of strangers (ie. bankers) for all of these shareholder friendly acts.

Who has it?

Let's now take a look at a few Canadian companies that have generated significant free cash in each of the past 10 years and how they have performed relative to the broad Canadian market over this period. Of the 239 companies that make up the S&P/TSX Composite, there were just 50 that accomplished this feat, so right away you know you're dealing in select company. Five of the more prolific free cash generators over this period are included in the table below:

Company Name	Combined FCF (MM)	10 Yr Return	Current Yi

BCE (TSX:BCE)	$20,344	41.6%	5.
Teck Resources (TSX:TCK.B)	$13,933	222.0%	3.
CN Rail (TSX:CNR)	$12,354	349.8%	1.
Rogers Communication (TSX:RCI.B)	$11,969	372.8%	3.
Potash Corp. (TSX:POT)	$3,778	457.8%	4.

Source: Capital IQ

When these returns are compared to the TSX's 10-year return of 66.4%, we find that only BCE was not able to eclipse the index. In fact, out of the entire group of 50, only 5 of the companies (including BCE) did not beat out the TSX over this 10-yr period. And when dividends are considered, BCE drops off that list.

The Foolish Bottom Line

To beat the market, free cash is not always necessary. However, if you want to increase your chances of achieving this feat, it certainly helps. Though investing isn't quite as easy as "find free cash flow, beat the market", it's also not as hard as some might have you believe.

Looking for more expert advice?

The Motley Fool Canada's senior investment analyst just unveiled his top two stock ideas for new money now. And **YOU** can be one of the first to read his buy reports — just click here for all the details.

Fool contributor Iain Butler owns shares of Teck Resources and Potash. David Gardner owns shares of CN Rail. The Motley Fool does not own shares in any of the companies mentioned at this time.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:BCE (BCE Inc.)
2. TSX:CNR (Canadian National Railway Company)
3. TSX:RCI.B (Rogers Communications Inc.)
4. TSX:TECK.B (Teck Resources Limited)

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