This Undiscovered Dividend Champion Yields 4.8%

Description

A dividend champion, in my valuation framework, has to meet a number of stringent criteria, which I discussed in an earlier article*.* To summarize briefly, a dividend champion has:

1. A strong track record of growing and uninterrupted dividend payments
2. A rock-solid balance sheet with manageable debt
3. Dividend payments that are adequately covered by free cash flow

This part of the analysis takes care of the historical assessment and provides some comfort that the company will be able to sustain dividend payments even during difficult times. In addition, the horizon needs to be scanned for factors that may influence future dividend payments. This requires a full assessment of the prospects of the business in question.

The North West Company (TSX: NWC) is a retailer of food and everyday products and services to rural communities and urban neighbourhoods in Canada, Alaska, the South Pacific, and the Caribbean. It operates 226 stores under the trading names Northern, NorthMart, Giant Tiger, AC Value Center, and Cost-U-Less, and has annualized sales of approximately $1.5 billion.

The company traces its roots back for centuries, with some store locations in Northern Canada and Alaska having been in operation for over 200 years. These northern stores serve smaller communities, with a typical store being around 7,500 square feet in size. These stores typically offer food, family apparel, housewares, appliances, outdoor products, and services such as post offices, income tax return preparation, quick-service prepared food, commercial business sales, money transfers, and cheque cashing.

The company has consistently been able to deliver higher profit margins and higher return on invested capital than its peers, including **Loblaw** (TSX: L), **Empire** (TSX: EMP.A), and **Metro** (TSX: MRU). Being able to cater to smaller, hard-to-access markets better than the larger retailers is a key capability and part of its overall business strategy.

The North West Company has built an enviable track record of profit and dividend growth over a long period of time. Dividend growth — which has been tax-adjusted for the conversion of a trust to a company in 2010 — has grown by more than 10% annually over the past 10 years, well ahead of the rate of inflation.

The balance sheet of the company is solid, with a debt-to-equity ratio of 54% and a debt-to-capital ratio of 32%. Interest payments are covered more than 10 times by the profit from operations.

The free cash flow of the business — that is, operating cash flow minus capital expenditures — covers the dividend payments adequately in most financial years. However, this was not the case in the 2013 financial year when the company made an abnormally large cash tax payment for previously accrued taxes. Given the one-off nature of the payment and the consistency of the company's operating cash flow, this is not considered a major risk for future dividend payments.

One factor that investors need to keep in mind is that the growth of the company, and the dividends, may be constrained for some time to come. The latest quarterly financial results until the end of April were below expectations mainly because of below-par profits in Canadian operations, where unseasonably cold spring weather caused disruptions to shopping patterns. However, the company indicated that trading conditions were expected to improve into the summer.

The dividend yield on the stock is a juicy 4.8%. Given the strength of the franchise, the long track record of above-average profitability and dividend payments, the solid balance sheet, sound cash flows, and reasonable business prospects, investors should consider this stock for income-focused portfolios.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:EMP.A (Empire Company Limited)
2. TSX:L (Loblaw Companies Limited)
3. TSX:MRU (Metro Inc.)
4. TSX:NWC (The North West Company Inc.)

Category

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