Which Is the Better Dividend Investment: Tim Hortons Inc. or Canadian Tire Corporation Limited?

Description

You might not think it, but **Tim Horton's Inc** (TSX: THI)(NYSE: THI) and **Canadian Tire Corporation Limited** (TSX: CTC)(TSX: CTC.A) have a lot in common.

Both companies pay reliable dividends, have been in business for decades, and represent all-things Canadiana. And unless people from B.C. to Newfoundland stop drinking coffee or buying snow shovels, both firms will likely be rewarding shareholders for decades to come.

That's why these dividend champions are favourites amongst income investors. But if you can't buy both, it can be tough to choose between these two wonderful businesses. Let's see how these two stocks stack up against one another on seven key criteria:

1. Dividend history

Canadian Tire has a great history of rewarding shareholders. The company started paying dividends to investors in 1999 and has hiked its distribution on 11 occasions over that time. Timmies is no slouch, either. Since going public in 2006, Tim Horton's has paid a dividend to shareholders every single year. *Winner: Canadian Tire*.

2. Dividend safety

Of course, we also want to measure a company's ability to maintain those dividends in the future. Canadian Tire has about $3.10 in debt for every dollar it earns before interest, taxes, depreciation and amortization, or EBITDA. That gives it lots of financial wiggle room if business sours.

However, following its merger with **Burger King Worldwide**, Tim Horton's will have $7.60 in debt and preferred shares for every dollar in EBITDA earned. That means the coffee giant's payout could be at risk if interest rates rise or margins tighten. *Winner: Canadian Tire*.

3. Dividend yield

Not hard to pick a winner here. While neither stock boasts a big yield, Canadian Tire's 1.7% payout is the highest of the two. So, this stock is your first choice for current income. *Winner: Canadian Tire*.

4. Moat

In the same way a moat protected a castle from attackers, a competitive advantage can protect a business from competition. If a company can earn high returns on invested capital, then that suggests it has a strong position in the marketplace. Over the past five years, Tim Horton's and Canadian Tire have earned 26% and 9% average returns on invested capital respectively.

This makes sense. While most people would probably shop around for the best price on auto parts or home appliances, they're won't skip their morning Tim's run even if it costs more. That means Tim Horton's will likely crank out larger returns in the decades to come. *Winner: Tim Horton's*.

5. Dividend growth

Dividend hikes put more cash in your pocket and sends a signal of confidence for the business. Afterall, executives are unlikely to raise investor expectations if they couldn't deliver. And since 2006, Tim Horton's has increased its dividend at a 20% annual clip, handily beating Canadian Tire.

However, given Tim's rocky balance sheet, you can expect most of its future cash flows will be directed towards debt repayments. Over the *next* five to ten years, Canadian Tire is much more likely to deliver big dividend hikes. *Winner: Canadian Tire*.

6. Earnings growth

Of course, future dividend hikes require growing profits. Based on analyst estimates compiled by *Reuters*, Canadian Tire is expected to grow earnings per share at a 8% compounded annual clip over the next five years. However, here Tim Horton's wins by a hair. Over that same time period, the coffee giant is expected to grow earnings per share at a 10% yearly clip. *Winner: Tim Horton's*.

7. Valuation

A wonderful business can still be a bad investment if you overpay for the stock. Investors are betting that Burger King will be able to unlock a lot of value out of Tim Horton's. That's why the stock trades at more than 30 times trailing earning.

Is that reasonable? It's a hefty price tag for a mature restaurant business. Canadian Tire, in contrast, trades at a more modest 16 times trailing profits. *Winner: Canadian Tire*.

The foolish bottom line

Both Tim Horton's and Canadian Tire are wonderful businesses that will crank out dividends for years to come. That said, following its merger with Burger King, Timmies is going to be saddled with a lot of debt. The company's days of double-digit dividend hikes are over. That's why *Canadian Tire has the edge in my books*.

CATEGORY

1. Dividend Stocks
2. Investing

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1. TSX:CTC.A (Canadian Tire Corporation, Limited)

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