Canadian Tire Corporation Limited Is Poised to Be a Dividend-Growth Superstar

Description

Dividend-growth investors tend to look at a company's dividend history before plunking down their cash on shares.

The logic goes like this: a company that has 10, 20, or even 30 years of consistently rising dividends is likely to keep the streak intact. Management knows a big reason why investors buy the stock is because it can help them build a consistent dividend stream for their retirement. And investors know that a company that is profitable enough to give shareholders an annual dividend increase is likely a pretty good business.

While I'd mostly agree with that logic, I think trying to look forward is even more important. Say that a company has a 4% yield, but is paying out all of its free cash flow, while a second company is only paying half of its free cash flow with the same yield. I'd rate the second dividend as more secure than the first, no matter how many years both companies have been around.

Thus, a company with a low payout ratio and a demonstrated commitment to dividend growth beats one with a high payout ratio, at least for investors concerned with dividend growth. Remember, a dividend growing at 10% a year takes just seven years to double. Those are the kinds of stocks dividend-growth investors should be looking for, not tired companies that are unlikely to see serious growth going forward.

Canadian Tire Corporation Limited (TSX:CTC.A) is the kind of dividend-growth company investors should be getting behind. Here's why.

Great brands

Canadian Tire is the owner of its namesake stores, as well as Sport Chek, Mark's, and PartSource stores.

You'll likely notice something about each of those brands. They're all the dominant players in niche markets. Sport Chek is the place to go for all your sports equipment. Mark's sells work clothes, creating a nice competitive advantage compared with all of the other clothing stores out there. And PartSource really only has one true coast-to-coast competitor besides Canadian Tire's automotive department.

Results have been good, especially from the sports segment of the business. Same-store sales at Sport Chek were up 8.5% in the third quarter, while Canadian Tire stores saw an increase of 3.4%. Mark's same-store sales declined slightly because of weakness in Alberta's oil patch. Energy employees are some of Mark's biggest customers.

Financial services

Kudos to Canadian Tire management for figuring out something many other retailers haven't–selling financial services is a much more lucrative business than selling things.

Look at it this way. In the third quarter, the retail part of the business did $3.4 billion in sales and ended up making a gross profit of $821 million. That's a profit margin of 29.1%. The financial services part of the company did $275 million in revenue during the same quarter, but earned a gross profit of $163 million. That's a gross profit of 59%, or more than double the gross margin from the retail side. And remember, the company doesn't have to build huge stores to capture those financial services dollars.

Dividend-growth potential

Most importantly for dividend-growth investors, Canadian Tire looks poised to be a dividend-growth machine over the next few years.

Currently, the company pays a dividend of $2.28 per share annual dividend, which was just recently hiked from $2.12. Over the last 12 months, earnings have been $8.09 per share. This puts Canadian Tire's payout ratio at a minuscule 28.2%.

With a payout ratio that low, Canadian Tire could raise the dividend by 10% per year for the next decade and the payout ratio would still be under 75%, assuming pretty much the worst-case scenario of earnings not growing a nickel.

Even if earnings don't grow over the next year–remember, Canada is in a recession, after all–Canadian Tire is still poised to grow its earnings per share. That's because the company is planning to buy back some five million of its own shares. That's a serious commitment for a company with just 76.2 million shares outstanding.

Canadian Tire is a terrific retailer. That alone makes it a stock you should consider. The potential dividend growth just makes it sweeter.

CATEGORY

1. Dividend Stocks
2. Investing

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

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