After Rising 500%+ in 5 Years Alimentation Couche-Tard Inc. Still Has More Upside

Description

The last five years have been kind to **Alimentation Couche-Tard Inc** (TSX:ATD.B), which operates well-known convenience stores such as Couche-Tard, The Pantry, Circle K, and Statoil. Shares are up 544% over that period, while peers such as **Casey's General Stores Inc.** are up less than half that.

Alimentation Couche-Tard was also able to boost its dividend by over 25% a year. While the yield has stayed below 1%, investors are likely more than satisfied with the capital gains. Plus dividends only represent 16% of earnings, meaning that the company can double or even triple it with ease.

As with all successful investments, however, investors must ask themselves one question: Can this continue? While results may not be as attractive over the next five years, there are plenty of reasons to believe shares will continue to reward patient, long-term investors.

Cash is key

When businesses grow at rapid speeds, the quality of earnings often deteriorates. For example, if a business is constantly acquiring other companies to grow, debt levels typically rise and earnings may not actually add any value due to share dilution and accounting gimmicks. Alimentation Couche-Tard is not one of those cases.

In 2008 free cash flow amounted to only $51 million. Today, it stands at $976 million, roughly 86% of earnings. Measuring free cash flow as a percentage of earnings is a quick way to determine how much cash a business is actually generating in comparison to simple accounting earnings. Alimentation Couche-Tard passes this test with flying colors.

How will the cash be used?

Historically, it looks like the company has used its cash well, expanding effectively in both Canada and abroad. Today 35% of sales are derived from outside of Canada, and profit margins are higher internationally. This diversification has been of particular benefit with the weak loonie.

Alimentation Couche-Tard still believes there is plenty of room for additional international expansion. In Europe, for example, the company only operates 2,229 stores compared to 7,987 in North America. Because profitability is higher in Europe than North America, shareholders should benefit from both higher revenues and profits.

With key interest rates on their way down again, Alimentation Couche-Tard shouldn't have any difficulty finding additional financing to continue past growth rates. It's acquired over 5,000 stores since 2004, and current debt levels are below the company average over that time period.

As an expert in tuck-in acquisitions with plenty of internal cash flows and external financing options, expect the company to continue growing into more profitable areas such as international markets.

After such a long rise in share price, is the valuation expensive?

With $2.1 billion in EBITDA for 2015, shares trade at 16 times trailing EBITDA. That’s certainly not cheap, but the valuation isn’t very egregious for a company that’s proven to create massive shareholder value over the long term. The TSX overall trades at roughly that same valuation. Alimentation Couche-Tard is certainly not a value stock, but if it continues to compound shareholder value anywhere near historical rates (which looks very possible), investors can expect to be rewarded.

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rvanzo