You Can't Go Wrong With These 8% Free Cash Flow Yields

Description

I'm currently reading *Market Masters,* a wonderful book by Robin Speziale; it examines Canada's top investors. Although I picked it up at the library, I'll likely buy a copy once I'm done because the 28 interviews contained within its pages are extremely helpful and illuminating. It's another tool for amateur investors to use to sharpen their skills.

And the best thing about the book? All 28 interviews are with Canadians. No Americans or Brits—just good, old Canucks.

The second interview in the book is with Barry Schwartz, chief investment officer with Baskin Wealth Management, a Toronto firm managing almost $1 billion in assets for clients in eight provinces.

The firm has a value slant that's all about fundamental analysis. In the book, Schwartz very succinctly explains the firm's approach to money management. One of his keys to investing revolves around free cash flow.

"When companies generate free cash flow and a higher amount of free cash flow, good things happen. If you shoot a bazooka, you're going to blow something up. It's the same effect with free cash flow. I've never made a bad decision by buying into a company paying 8% or 9% free cash flow yield or higher," Schwartz said.

While not every company is going to deliver this kind of free cash flow yield, those that do always seem to come up smelling like roses over the long haul.

So, who are these cash generators? On an inverse basis, they are those stocks currently trading for 12.5 times free cash flow or less. Out of 318 TSX stocks with a market cap greater than $500 million, only 51 make the cut.

Here are three I believe are worth considering.

Great Canadian Gaming Corp. (TSX:GC)

Schwartz looks for businesses that don't require a whole lot of capital to keep the doors open. Commonly called "asset light," these businesses tend to have pricing power over their customers. Gambling establishments would certainly fit the bill.

With gaming, entertainment, and hospitality facilities in B.C., Ontario, New Brunswick, Nova Scotia, and Washington State, the company has generated free cash flow of $126 million annually on average over the past three years.

Currently, its free cash flow yield is 9.2%. Its free cash flow as a percentage of total assets is 12.6%.

If you don't have a problem with sin-related businesses, it's got your name written all over it.

TransForce Inc. (TSX:TFI)

This is a company that people pay attention to if they're trying to get a sense of how the overall economy is doing. With hands in truckload, less-than-truckload, package, and courier, as well as logistics services for companies looking for expertise on moving goods, it's got the entire shipping spectrum covered.

Here's a good example of how its diversified business model is able to keep the company growing: in the second quarter, volumes in its truckload business were way down because of a challenging market. However, by using an asset-light focus on its brokerage activities (getting stuff through the borders), it's been able to generate better returns on capital despite the truckload's segment's weaker volumes.

It has averaged annual free cash flow of $213 million over the past three years, and it currently yields 8.3%. Its free cash flow as a percentage of assets is 7.1%.

It's not quite as strong as Great Canadian Gaming, but it's still a solid showing.

Linamar Corporation (TSX:LNR)

In June I highlighted a few reasons why I thought the Guelph auto parts manufacturer was down but not out. It's an Ontario success story whose management has found a way to steer the company through some serious downturns in the automotive industry.

It continues to invest in its business, so I see nothing but a bright future ahead of it. Since I wrote about Linamar in June, its stock has regained about 7% of its losses year-to-date. It has now regained more than 20% in 2016, so it appears that Linamar is going to have its first down year since 2011.

No matter. Its current free cash flow is averaging $316 million over with the past three years with a yield of 8.7%. It's not quite as asset light as the previous two, but its free cash flow as a percentage of assets is 5.9%. By comparison, **Magna International Inc.** has a free cash flow yield of 5%, while its free cash flow as a percentage of assets is 4.9%.

Linamar is clearly the better buy.

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1. Editor's Choice

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1. TSX:LNR (Linamar Corporation)
2. TSX:TFII (TFI International)

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