Is the Number 1 Consumer Staples Stock a Bargain?

Description

Since it opened its first convenience store in 1980 in Quebec, **Alimentation Couche Tard Inc.** (TSX:ATD.B) has grown into more than 12,000 stores around the world.

It has about 7,800 stores in North America, roughly 2,700 stores in Europe, and more than 1,500 stores operated by independent operators internationally.

The closing of the **CST Brands** acquisition in 2017 will further strengthen Couche Tard's position in North America.

Proven track record of acquisitions

Couche Tard has had a strong track record of growing by acquisitions. In 1980-1990, Couche Tard consolidated the Canadian market. In 2001, it began its expansion into the United States.

In 2003, the company acquired the Circle K Corporation from **ConocoPhillips**, which, at the time, operated 1,663 Circle K corporate stores across 16 States and had a franchising or licensing relationship with 627 additional stores in the U.S. and around the world.

Since fiscal 2005 Couche Tard has acquired more than 6,000 stores across multiple transactions.

Image not found or type unknown
couche tard

Growing profits

The successful integrations of the acquisitions have led to higher profits. For example, since 2010 Couche Tard's gross profits have grown at a compound annual growth rate (CAGR) of 16% to more than US$6 billion.

In the same period, its earnings before interest, taxes, depreciation, and amortization have increased at a CAGR of 24%.

Every year from 2011 to 2016, Couche Tard's return on equity was above 20% and was the highest in

2016 at 27%. In the five-year period, its diluted adjusted earnings per share increased at a CAGR of 26%.

Growing dividends

Couche Tard's dividend growth has more or less followed its free cash flow growth. From fiscal 2011 to 2016 its free cash flow grew at a CAGR of 23%, and its dividend grew at a CAGR of 26%. Its quarterly dividend per share is 33% higher than it was a year ago.

Free cash flow growth is telling. Free cash flow is the cash left after subtracting capital spending, dividends paid, income tax paid, and interest paid from the cash generated from the company's operations. In fiscal 2016, Couche Tard's free cash flow was more than US$1 billion.

Strong cash flow generation allows the company to deleverage quickly, maintain a strong financial position, and look for other growth opportunities.

Going forward

The CST Brands acquisition is expected to close in early 2017 and will strengthen Couche Tard's presence in Texas–a fast-growing and business-friendly state.

CST Brands earns 73% of its gross profits in the U.S. and 27% in Canada. After the integration, Couche Tard will have more than 10,000 stores in North America and is expected to earn 63% of its gross profits from the U.S., 20% from Europe, and 17% from Canada.

Similar to the synergies that Couche Tard has extracted from its previous acquisitions, the CST transaction is expected to reduce costs. The company expects to generate US$150-200 million pre-tax cost synergies every year after 24-36 months of closing the CST transaction.

At the same time, the merger should be accretive to earnings within the first year after closing and achieve $0.40-0.50 earnings per share accretion by the third year of closing.

Conclusion

As Couche Tard continues to consolidate the fragmented convenience store market, it will generate higher profits that will translate into a higher dividend and share price. Since 2007 Couche Tard shares have generated annualized returns of 23%. In the same period, its dividend has grown at a similar pace.

Now that the quality shares have retreated from a recent high of $68 to below $62, the company trades at a reasonable forward multiple of about 19.4. So, buyers today can expect double-digit returns and a fast-growing dividend.

In fact, the analyst at **Bank of Nova Scotia** gives Couche Tard a one-year price target of $80, which implies 30% upside potential.

CATEGORY

1. Dividend Stocks
2. Investing

Category

1. Dividend Stocks
2. Investing

Date
2025/08/16
Date Created
2016/12/08
Author
kayng