Transcontinental Inc. up 22% in Past Year But Still a Buy

Description

Transcontinental Inc. (TSX:TCL.A) announced April 13 that it was selling its Atlantic Canada newspaper assets to SaltWire Network Inc., the current owners of the *Halifax Chronicle Herald*. Five days later, it announced plans to sell its 93 local and regional publications and related web properties in Québec and Ontario, including Metro Montreal.

Transcontinental is in the middle of a transformation which started in 2014 with the acquisition of a flexible packaging company in Missouri, another acquisition in 2015, and two more in 2016, creating a flexible packaging division to complement its printing business.

The printing and packaging business accounted for 84.9% of its $2.1 billion in 2016 revenue with media accounting for the remainder. Moving forward with profitable growth, the latest announcements will shrink the size of its media business considerably, and that's a good thing.

Regarding the bottom line, its printing and packaging business accounted for 96.4% of its $283.4 million in adjusted operating earnings in 2016 — 140 basis points higher than a year earlier.

Last June, I suggested to readers that Transcontinental was an income investor's dream stock because of its 4.2% dividend yield and free cash flow generation. It was trading near its 53-week low of $16.27 at the time, and its stock is up 38.8% since then, significantly better than the S&P/TSX Composite Index.

Even though it's done very well in the past year, I believe it's still got a lot of room to run. Its dividend yield is obviously lower given the gains in recent months, but it still delivers 3.4% — 72 basis points higher than the **iShares S&P TSX Capped Composite Index Fund**.

As for free cash flow, Transcontinental generated $223 million in 2016, 6.2% higher than a year earlier. Its free cash flow yield is 12.1%; anything over 10% is considered good value. Its enterprise value is $2.2 billion, or 5.6 times 2016 adjusted EBITDA. By comparison, **Bombardier's** enterprise value is 21.9 times EBITDA.

Why is it so cheap?

Over the past decade, its revenues have shrunk by 15% as businesses have gone digital, reducing the need for printing services. However, because Transcontinental has managed to keep an eye on expenses, cutting out the fat, it's been able to maintain or grow its free cash flow. As a result of adhering to a disciplined spending plan, the company has increased the annual dividend every year from $0.17 in 2004 to $0.80 in 2017 — a compound annual growth rate of 12.7%.

There's one more thing to consider: in 2013, Transcontinental paid a special dividend of $1. In fiscal 2016, it paid out $56.2 million in regular dividends and repurchased $21.5 million of its stock. With 63.4 million shares outstanding, it would only cost the company another $63.4 million in free cash flow to dole out another $1 special dividend.

If we hit the end of the summer, and it hasn't made a significant acquisition in its flexible packaging business, I wouldn't be surprised if it pulled the trigger on another special dividend. Remember, except for the December 2016 purchase of some business publications from **Rogers** for $3.9 million, it's only divested assets so far in fiscal 2017; thus, cash is coming in faster than it's going out.

If you're an income investor, I don't see why you wouldn't want to own Transcontinental. It's up 22% over the past year, so I still think it's a buy.

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