Is Canadian Tire Corporation Limited a Buy at 15 Times Earnings?

Description

Things were going well for long investors of **Canadian Tire Corporation Limited** (TSX:CTC.A) until the early part of May. Hitting a 52-week high of $171.91 on May 11, 2017, shares have since fallen to a much more attractive price of $147. With a lower share price, investors looking at this name have the opportunity to receive a dividend yield of approximately 1.75%. Although some may not consider this very high, it is important to note that the company is a successful retailer with a significant amount of potential.

Before delving into the specifics, investors need to look at the big picture to properly benchmark the company. As a retailer with close to 1,700 locations comprised of Canadian Tire stores, FGL Sports, Mark's Work Warehouse, and the Canadian Tire gas bar, this company can be identified as a defensive security, which translates to investors paying higher premiums for shares. Metrics such as price to earnings (P/E) will be higher, while the metrics such as the dividend yield will typically be lower. Given the high probability of recurring revenues, earnings, and dividends, investors are justified in their willingness to pay a premium.

Starting at the top line of the balance sheet, the company has successfully increased revenues from fiscal 2013 to fiscal 2016 at a compounded annual growth rate (CAGR) of 2.47%. Although this is not a huge number, investors must remember that this is a mature company. In evaluating company management, we can compare the CAGR of earnings per share (EPS) over the same period. EPS increased at a rate of 10% from $6.91 to $9.22 in comparison to the 2.47% increase in revenues. Clearly, management has done a fantastic job at creating efficiencies within the company. EPS increased at four times the rate of revenues over the past four fiscal years!

What matters most to investors is how well they have come out of this situation. Over the past five years, shares have increased by more than 110%, while the dividends paid to shareholders have increased in each of the past four years. Investors have continually been rewarded in greater and greater dollar amounts. The dividend-payout ratio did not vary by much over this same period though.

Over the past four fiscal years, the dividend-payout ratios have been 25% (2016), 24% (2015), 25% (2014), and 20% (2013). Given these percentages, the question is, where did the rest of the profit go?

Since fiscal 2013, the total number of shares has declined from 79.98 million to 70.75 million at the end of fiscal 2016. Given that the company has bought back more than $400 million of stock in each of the past two fiscal years, investors can expect the total number of shares outstanding to continue to decline as the years pass. The benefit to shareholders will, of course, be higher EPS with the potential to spread the total amount of dividends paid over a fewer number of shares. Time will tell.

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