



After a 38% Dividend Increase, Should Investors Buy This Name?

Description

After reporting third-quarter profit in the amount of \$2.59 per share, **Canadian Tire Corporation Limited** ([TSX:CTC.A](#)) raised the dividend from \$2.60 per year (\$0.65 per quarter) to \$3.60 per year (\$0.90 per quarter). Essentially, investors received excellent news from the company, and shares increased from approximately \$158 to more than \$164 in the days that followed. Although the initial reaction was very favourable to those who owned the stock, the truth is that there is [a lot more to consider](#) than the dividend raise alone.

As shares of this Canadian retail giant are indicative of the entire economy, it may be difficult for the company to experience higher than average rates of growth. What investors may instead want to take away from this most recent dividend increase and the \$550 million share-repurchase announcement is that the growth of the company will be lower on a go-forward basis. Essentially, the company has the potential to turn into a very defensive dividend-paying aristocrat.

At a current price of \$161 per share, the company will now offer investors a dividend yield of almost 2.25% based on (what is expected to be) a payout ratio of less than 40% of earnings. Depending on how the Canadian economy performs over the next year or two, investors could either see another increase in the dividend (as the amount of shares outstanding will decrease), or, if it goes the other way, a very high payout ratio and a decline in the share price, thereby increasing the dividend yield.

For investors buying shares today will get a total return of less than 10%, as the higher payout ratio will limit the performance of the share price (from an appreciation standpoint) and the share-repurchase program will increase the amount of leverage of the company. Shareholders with high expectations will be disappointed in the future.

Although the share-repurchase plan may help the company increase the amount of earnings per share (EPS), the challenge may very well arise if the company does not have the capital available to execute the repurchases. As Canadian Tire only has \$365 million in cash on the balance sheet, investors will have to be very cautious if they believe that the buyback program is a “done deal.”

After the first three quarters of this year, the statement of cash flows shows cash flows from operations

(CFO) of only \$135 million. Interestingly enough, the increase in working capital totals close to \$1 billion, as the company (in the month of September) was already committing additional dollars to [filling store shelves](#). In the previous fiscal year, CFO was \$986 million and \$978 million in the year before that.

Although there is a lot of good news coming from Canadian Tire Corporation Limited, investors may want to pause before jumping on the bandwagon!

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Date

2025/08/25

Date Created

2017/11/19

Author

ryangoldsman

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