Quebec Company’s Latest Acquisition Makes it a Buy

Description

The announcement by **Transcontinental Inc.** (TSX:TCL.A) April 2 that it was paying US$1.3 billion for Coveris Americas, a Chicago-based manufacturer of flexible packaging, ought to be music to shareholders’ ears.

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And if you don’t own TCL.A stock, the latest move by Transcontinental makes it a buy. Here’s why.

Coveris Americas had 2017 revenues of US$966 million, generating adjusted EBITDA of US$128 million from 21 facilities across North America. Prior to the acquisition announcement, Transcontinental’s packaging business generated about 15% of its 2017 revenue and 11% of its adjusted EBITDA.

Upon completion, Transcontinental will have approximately $3.3 billion in annual revenue and $564 million in adjusted EBITDA. Packaging will account for 48% and 37% of its overall revenue and adjusted EBITDA.

While it might be a huge bite to swallow, it’s a deal that will deliver greater balance to Transcontinental’s overall business and improved growth.

Analysts like it

The initial reaction to the acquisition is positive.

“It makes [Transcontinental] a major player in flexible packaging in North America, opening up a number of expansion opportunities across new customers and product categories, in addition to offering cost rationalization and margin expansion,” wrote Aravinda Galappatthige, an analyst with **Canaccord Genuity**, in a research note Monday.

In June 2016, I’d called Transcontinental an income investor’s dream stock. My rationale was simple. Transcontinental’s free cash flow suggested that it was insanely cheap. Fast forward to 2018, and not much has changed.

Back then, its free cash flow yield was 18.4%; today, not including the Coveris Americas acquisition, it's 13.9%. Anything above 8% is considered value territory.

As an income investor, your biggest concern is that the company keeps paying its dividend. In 2017, Transcontinental had $291 million in free cash, or almost five times the $61 million paid out in dividends.

The Coveris Americas deal only increases its free cash flow generation due to the cost savings synergies from merging both companies' packaging businesses.

Ten months later, I'd said Transcontinental's stock still had a lot of room to run given it was still in the early stages of its transformation into a printing *and* packaging company; it's up another 11% over the past year.

How much higher can it go?

The sky is the limit.

Seriously, unlike newspapers, people still need to buy products that require packaging. This transformational deal makes it the seventh-largest flexible packaging company in North America ahead of Winnipeg-based **Winpak Ltd.**, a company I also like.

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One of Coveris Americas's specialties is pet food packaging. As an owner of several cats, I'm reminded on a daily basis just how big the pet food business has become, and it shows no signs of slowing down.

I've liked Transcontinental for a couple of years now. The acquisition of Coveris Americas certainly cements that opinion.

Transcontinental is a strong buy.

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