This High Growth Dividend Aristocrat Is on Sale

Description

Canadian Tire (TSX:CTC.A) has proven that it can survive and come out stronger from a recession while keeping a safe and growing dividend. With the dividend aristocrat having corrected about 17% to an attractive valuation, now's an opportune time to consider the stock for outsized long-term returns potential.

Canadian Tire is a Canadian icon whose roots stretch as far back as its founding in 1922. Today, it has an umbrella of brands, including Canadian Tire (of course!), Marks, FGL Sport Chek, Sports Experts, Atmosphere, etc. under its wings. As well, it also has PartSource, which sells automotive parts, owns Gas+ gasoline stations, and owns a controlling stake in **CT REIT**.

How did Canadian Tire fare in the last recession?

Canadian Tire has a fairly recession-proof business. In the last recession, its adjusted earnings per share (EPS) declined about 15% over a two-year period from a peak in 2007. By 2010, the quality retailer's adjusted EPS more than recovered to the 2007 levels.

The company maintained its dividend in 2009 with a payout ratio of 20%. Otherwise, it would have had increased dividends every year since 2004. There isn't an explanation for the dividend freeze other than prudent management practice in the face of an adverse global economy.

Strong dividend

Canadian Tire is a dividend aristocrat that has increased its dividend per share for eight consecutive years and has at least maintained its dividend every year since 2000.

The retailer's three-, five-, and 10-year dividend growth rates are all outstandingly high at 19.7%, 20.8%, and 16%, respectively. CT last hiked its dividend in November 2018 by 15%, which was superb.

Currently, CT stock has an annual payout of $4.15 per share, which equates to a decent yield of 3.1%. The dividend is kept safe by a low payout ratio that's estimated to be roughly 33% this year.

Profitability

Compared to the prior year, in 2018, Canadian Tire generated $14 billion of revenue, up 5.9% and $1.6 billion of EBITDA, down 2.7%, as the EBITDA margin declined 90 basis points to 11.7%. Net income was $778 million, up 5.9% from the prior year, while adjusted EPS increased 12% to $11.95 thanks to a reduced share count from stock buybacks.

CT's recent return on assets (ROA) and return on equity (ROE) are about 4% and 16.6%, respectively, compared to the five-year ROA and ROE of 4.4% and 13.9%. Going forward, we would like to see the ROA remaining solidly above 4% and the ROE above 13%. It was good to see that CT's recent operating margin was 9.2%, higher than the five-year margin of 8.7%.

Returns potential

Canadian Tire stock is on sale! At $134.60 per share at writing, the stock trades at a blended price-to-earnings (P/E) ratio of just under 11, which implies a meaningful discount from its long-term normalized P/E of 13.7.

Assuming a more moderate EPS growth rate of 10% per year and a safe dividend yield of about 3%, the stock can deliver total returns of about 13% per year. A P/E multiple expansion to 13.7 in five years will add about 4.5% per year to total returns. Thus, an estimated total return of about 13-17% per year is possible.

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