Buy Alert: Why Does This TSX Stock Yielding 6% Has Significant Upside Potential?

Description

When it comes to investing in dividend stocks, you need to consider several aspects. The company's financials need to be strong so that they can keep paying dividends even during an economic downturn. The best dividend companies are those that have increased payouts in subsequent years and have the potential to keep doing so.

One such Canadian Dividend Aristocrat is **Transcontinental** (TSX:TCL.A), a Canada-based printing, publishing, and packaging company. It reported sales of $3 billion in 2019 and ended the year with 40 operating facilities.

Transcontinental stock is trading at $14.85, which is 15% below its 52-week high. This pullback has meant the stock has a forward yield of 6.06%. Canada's packaging giant has increased dividends for 18 consecutive years.

Since 2010, its dividends have increased at an annual rate of 10.6% from $0.35 to $0.87. So, if you bought 357 Transcontinental shares worth $5,000 in July 2010, you would have generated $125 in annual dividend payments. These payouts would have increased to $311 in 2019, which means your dividend yield would have risen from 2.5% to 6.2% in this period.

In 2019, Transcontinental paid shareholders $76 million in dividends which was just 17.6% of its operating cash flows. In the last 12-months, Transcontinental's operating cash flows stood at $427 million and it spent $121 million in capital expenditure, $77 million in dividends, and $7 million in share buybacks.

We can see that the company has enough room to keep increasing dividends at a double-digit rate in the upcoming years.

Focus on the high margin packaging sector

Over the years, Transcontinental has focused on increasing sales in its high-margin packaging segment. In 2014, its packaging sales accounted for just 2% of total revenue while printing sales were 69% followed by media or publishing at 29%. In 2019, the packaging business accounted for 53% of sales followed by printing at 44% and media at just 3%.

Its long-term strategy includes growing packaging sales through organic growth and acquisitions. In 2019, Transcontinental completed the acquisition of Coveris America and fully integrated its operations, making the company a market leader in North America's packaging space.

The company has increased sales from $2 billion in 2015 to $3.03 billion in 2019 while adjusted EBITDA has risen from $379 million to $476 million in the same period.

While the ongoing pandemic has hurt multiple sectors, Transcontinental has managed a part of the broader market decline by focusing on the increased demand for food packaging.

Valuation and target price

Transcontinental stock has a market cap of $1.3 billion. It has a price-to-sales multiple of 0.46 and a price-to-book ratio of 0.76. Analysts tracking the stock estimate the company's earnings per share to reach $2.06, indicating a price to earnings multiple of 7.2.

Analysts also have a 12-month average target price of $18.63 on the stock which is 25.5% higher than the current price. If you include the dividend payouts, annual returns can be close to 32%.

Transcontinental stock remains a top dividend stock given its low payout ratio, huge presence in the printing and packaging space, and focus on inorganic growth.

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