The Stock Picker's Guide to Canadian Tire for 2014

Description

What a difference a year makes. At this time last year, shares of **Canadian Tire** (TSX:CTC.A) were trading at about $70. There were constant headlines about the impending arrival of **Target** (NYSE:TGT) and the effect it would have retailers like Tire. Growth in the flagship stores was anaemic, and management was still facing criticism for the acquisition of Forzani Group.

The tide started to turn when Tire announced in May it would be creating the **CT Real Estate Investment Trust** (TSX:CRT.UN) from most of its landholdings. The company later announced plans to partner with a bank on its credit card portfolio. Meanwhile, Target struggled with its Canadian launch, and didn't steal as many of Tire's customers as some initially feared. By year-end, the stock was trading in the high $90s.

Canadian Tire's business can be thought of as the sum of three pieces, each of which saw a very eventful 2013: retail operations, financial services, and real estate.

The retail operations created plenty of headlines last year, which reflects how aggressive Tire has been. The company has retrofitted many of its existing locations and opened small-scale stores in more central areas. Tire has expanded its Sportchek banner and supplemented its sports offerings with the acquisition of Pro Hockey Life. The company has stepped up its marketing efforts – Tire acquired the name of the Ottawa Senators arena, became the official provider of Team Canada Olympic apparel, and even built a truck out of ice.

Two lesser-known initiatives may have an even bigger impact. In April, Tire signed a new agreement with its franchisees (known as "dealers"), which supposedly could make operations run much more smoothly. Also the company is continuing its pilot of a digital loyalty program in Atlantic Canada.

The financial services side is much more significant than most people realize, accounting for almosthalf of Tire's pre-tax income. The segment had a very successful 2013, with profits up over 15%. The prospect of Tire partnering with a bank adds further upside; recent credit card deals, such as **TD**'s acquisition of the Target and Aeroplan portfolios, demonstrate the value that banks place on credit cards.

Before May, the value of Canadian Tire's real estate was likely underappreciated. But that all changed with the creation of the CT REIT. The shares jumped by about $10 on the announcement, even though the company plans to sell less than half of the REIT's units. Interestingly the REIT transaction came only five months after **Loblaws** (TSX:L) announced a similar initiative – with a similar bounce in the stock price.

Foolish bottom line

Last year, Canadian Tire executives claimed that the company was "on offence". But that is an understatement. With all the initiatives the company is pursuing, "swinging for the fences" would be much more accurate. If Tire ends up being successful on all of these, then today the stock is seriously undervalued, despite appreciating by nearly 50% in 2013 – the company's shares still trade at only 15 times earnings. But if Tire runs into problems, fixing them will require a lot more than duct tape.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:CTC.A (Canadian Tire Corporation, Limited)

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Date
2025/07/27
Date Created
2014/01/30
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