Why Canadian Tire Corporation Limited Shares Are Worth More than They Are Today

Description

Investors in **Canadian Tire Corporation Limited** (TSX:CTC.A) have enjoyed an 87% increase in share price since the beginning of 2013, and the very factors that caused the appreciation in share price, after years of very flat performance, will likely lead to another leg up in the stock.

Canadian Tire is currently one of Canada's largest retailers and Canada's largest sporting goods retailer, with a massive 32% control of the sporting goods market. While the Canadian Tire brand is the company's most well-known brand, Canadian Tire also owns numerous diversified high value brands, including Mark's, Sport Chek, Sports Experts, and PartSource.

Back in 2006, hedge fund manager Bill Ackman of Pershing Square Capital purchased a large portion of Canadian Tire shares, and suggested that Canadian Tire shares (which were worth $66 at the time) could be worth $129 if the company sold its credit card portfolio and some of its high-value real estate.

While the company did not act on Ackman's recommendations for about eight years, they recently did, and it drove the share price to (quite coincidentally) $129 per share as of the beginning of August. There is still further upside remaining from both these value-creating activities, and further growth in its retail segment.

Canadian Tire REIT can be a continued source of value

One of Ackman's main recommendations was that Canadian Tire should sell off its real estate holdings, and in 2013 the company did just that with the creation of the Canadian Tire REIT, known as **CT Real Estate Investment Trust** (TSX:CRT.UN).

What was the purpose of this transaction? Quite simply, Canadian Tire possesses extremely large and well-diversified real estate holdings. These extensive real estate holdings have significant value, most of which is not recognized within the entire Canadian Tire structure. By creating a REIT, Canadian Tire can effectively sell a large portion of its real estate and realize the full value of its real estate portfolio, while freeing up capital to be deployed elsewhere in the organization.

This accomplishes a few things. Firstly, Canadian Tire will receive capital to expand its higher-growth retail division. Without all of the real estate assets, investors will focus more deeply on the company's retail-growth potential. Secondly, since REIT investors value solid, stable cash flows and due to the tax-advantaged nature of REITs, Canadian Tire will be able to unlock the full value of its real estate assets through the sale.

While the initial transaction created value, there is still more value to be created. Canadian Tire did not sell all of their real estate assets, and over the next several years it will continue to vend these assets into the REIT. These assets will be transformed into cash at a higher value than they are currently worth within Canadian Tire, which will further enhance the share price and provide capital for future growth, or enable a reduction in debt.

Canadian Tire has many other growth levers available

While the REIT does offer a future source of growth, there are numerous other sources available. Firstly, the company currently has a large amount of surplus cash available. Canadian Tire's retail operations have adjusted net cash (cash subtracting debt) of $2.1 billion, which is an extremely large figure especially considering the segment's earnings.

In addition, the company is expected to generate free cash flow of about $600 million annually going forward. The end result? Canadian Tire has significant resources to fund growth. This may come in the form of another major acquisition. Very likely, however, is that Canadian Tire will continue to return cash to shareholders. The company has been buying back shares, which will continue for the remainder of this year and possibly going forward.

It is also very likely the company will increase its dividend. Canadian Tire shares are trading at a bargain to its peers, including **Rona**, **Home Depot**, **Lowe's** and **Wal-Mart Stores** according to analysts at **Royal Bank of Canada.** Simply closing this gap could drive the share price much higher.

CATEGORY

1. Investing

TICKERS GLOBAL

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