



Canadian Tire Corporation Limited Gets a Flat Tire

Description

It's been almost three weeks since **Canadian Tire Corporation Limited** ([TSX:CTC.A](#)) reported first-quarter results that included a 37.8% increase in earnings per share.

Is all well with Canada's iconic retailer? Not quite.

It seems the company has a few issues to remedy that could continue to put downward pressure on its stock price. The stock sailed up 19.4% year to date through May 10, the day before releasing its quarterly earnings; it's down 8.2% since then.

Canadian Tire has been a TSX darling over the past five years, so it's unusual to see investors reacting so negatively to an earnings report that showed it's doing just fine on the bottom line.

In the first quarter, Canadian Tire increased earnings to \$1.24 per share from \$0.90 a year earlier. On a dollar basis, they rose by 31.6% to \$87.5 million. EBITDA in Q1 2017 increased 14.9% to \$284.4 million, a margin of 10.3% and 60 basis points higher than in the same quarter a year earlier. Like a cherry on top of a sundae, its retail EBITDA increased 30.5% to \$126.5 million with a margin of 6.2% — 110 basis points higher than last year.

Top-line revenue numbers can vary from quarter to quarter, but if earnings stop growing, a company's share price is bound to take a hit.

What's the problem?

It would be easy to blame its sports business (FGL Sports), which saw retail sales and same-store sales decline by 1.4% and 2.7%, respectively, in the quarter. That's a considerable drop from Q1 2016, when retail sales and same-store sales increased by 7.2% and 7.6%, respectively.

Perhaps Canadian Tire is a little too reliant on weather; it's taking steps to reduce its dependence on Mother Nature by opening separate Sport Cheks for both women and children.

Overall, FGL Sports has been an excellent performer since Canadian Tire acquired it for \$771 million

in 2011, so I wouldn't lose much sleep over the segment's performance.

I'm more concerned about the legacy Canadian Tire brand.

While acquiring Forzani Sports in 2011 was a stroke of genius, in the years ahead, there aren't going to be many other acquisition opportunities available of this size in Canada.

If Canadian Tire stock is going to continue to push higher, it's got to get more out of ... Canadian Tire.

The legacy is the key

In the first quarter, the Canadian Tire brand had \$1.4 billion in revenue, or \$401 per square foot. In the same quarter five years ago (Q1 2012), it had revenue of \$1.2 billion, or \$389 per square foot. That's a compound annual growth rate of 3.1% on revenue and 0.6% on a sales-per-square-foot basis.

That's not nearly good enough given the Canadian Tire brand (excluding petroleum sales) accounts for 68% of the company's overall retail revenue.

Fool.ca contributor Joey Frenette [reckons](#) that home delivery could be the answer to Canadian Tire remaining competitive in the retail space. Certainly, it's got to figure out the appropriate balance between e-commerce and its brick-and-mortar footprint. After all, if you abandon the Canadian Tire dealers, you don't have a business.

Another initiative is to fill your stores with your own products.

Canadian Tire just announced that it's buying Padinox Inc., the owners of the Paderno kitchenware brand, based in Charlottetown. Canadian Tire is keeping the Paderno name while selling the manufacturing and wholesale distributions to Meyer Canada.

Canadian Tire's own brands generate about one-third of its overall revenue. The acquisition of Paderno strengthens its private-label business in the kitchenware category. While it's hard to know exactly how much this acquisition means to the legacy brand's overall revenue, it should at least fatten the margins.

Bottom line

Don't get me wrong; I still believe Canadian Tire is one of the best merchandising stocks to own on the TSX.

However, it's got to do a better job with the main brand, because when you've got 21.1 million square feet of retail space underperforming, eventually your stock is going to take a hit.

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