Is Canadian Tire Corporation Limited the Best Buy in Retail?

Description

Retail might suck for a lot of companies in both Canada and the U.S. right now, but you wouldn't know it at **Canadian Tire Corporation Limited** (TSX:CTC.A), whose second-quarter results suggest it might be the best buy in Canadian retail.

But before I'm ready to crown the iconic Canadian retailer, I've got to look at some of the pros and cons of Canadian Tire's business.

Same-store sales

Same-store sales, a vital key productivity indicator (KPI) in the retail industry, were all positive in Canadian Tire's second quarter with Mark's leading the way, up 4% with sales per square feet growing an impressive 5.6% to $342. Overall, Canadian Tire's same-store sales were up 1.8%.

That's the good news. Unfortunately, for long-time Canadian Tire shareholders, there are some troubling aspects to its Q2 report.

Overall, same-store sales were almost half the 3.4% growth registered in the same quarter a year ago. Year to date, Canadian Tire's overall same-store sales have grown just 1.2%, less than half the 3% delivered in the first six months of 2016.

Can you see the deceleration? I can.

FGL Sports missing the mark

Canadian Tire set a three-year growth target for all three of its brands back in 2015; FGL Sports's target was annual retail sales growth of 9% — a high bar, to say the least. It's failed miserably to meet that target, which could lead to defections of key staff.

In the first six months of 2017, FGL Sports's retail sales growth is 1.3%, one-fifth the rise in the first half of 2016. Without the addition of five new Sport Chek stores over the past year, FGL Sports most likely would have negative retail sales growth through the first two quarters of the year because its same-store sales growth was barely positive at 0.1%.

CEO Stephen Wetmore sees the latest hiccup as a weather-related issue that isn't an ongoing concern.

"Looking forward, I believe we have great potential for FGL and specifically Sport Chek that continued to deliver strong growth and profitability as it now transitions out of a period of expansionary growth to a phase focused on generating higher returns from our existing assets," Wetmore said during the second-quarter conference call.

Two things are important about that statement — one is good; one is bad. Despite the less-than-stellar revenue growth, FGL Sports is still very profitable. That's the good part. The bad is that FGL Sports is failing miserably in the third year of a three-year plan that was supposed to produce significant growth.

Now, with Canadian Tire focusing on generating higher returns from its existing footprint, growth is going to be even harder to come by.

Who's better?

Profits aren't an issue at Canadian Tire, and now that it's slowing its expansion at FGL Sports, free cash flow is ramping up. In the first six months of 2017, free cash flow was -$77.8 million — $410 million higher than in the first half of 2016.

Cash return is defined by *Morningstar* as free cash flow + net interest expense divided by enterprise value. Canadian Tire's is currently 2.8%. Investors should expect that to rise in the future.

Dollarama Inc. (TSX:DOL), whose market cap is about 30% greater than Canadian Tire's, has a cash return of 2.9% — virtually identical. However, Dollarama's margins are higher, as is its same-store sales growth.

While Canadian Tire is a safe buy for dividend investors, Dollarama appears to be the better buy.

Is Canadian Tire the best buy in retail? I don't think so.

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