



Is Canadian Tire Corporation Limited (TSX:CTC.A) Overextending Itself?

Description

Canadian Tire ([TSX:CTC.A](#)) recently announced that it is partnering with **Petco**, a San Diego-based pet food and supplies retailer, which will sell its private label pet food and treats exclusively in Canadian Tire stores.

On the surface, the move makes a lot of sense given 65% of Canadian Tire customers own one or more pets. Petco is one of the biggest pet store retailers in the U.S. and is likely a name many Canadians recognize from their travels down south.

Also, Canadian Tire already sells pet food and other supplies at its stores and is acutely aware of the growth in pet food in North America.

“Petco’s deep expertise in pet products, combined with Canadian Tire’s extensive reach in a thriving pet market is a powerful combination,” said Greg Hicks, president, Canadian Tire Retail, in its August 8th press release.

All’s good with the world. Right? Not so fast.

Missed earnings

Canadian Tire released its second-quarter earnings August 9. While revenues grew by 3.2% to \$3.48 billion, profits fell by 20% to \$156 million and, on a per-share basis, [missed](#) the \$3.06 consensus estimate by \$0.68.

The company blamed the bottom-line miss on bad April weather that reduced its top-line growth, which, in turn, affected its profitability in the quarter.

Indeed, spring was terrible across most of North America, so it’s not unusual to see Canadian Tire trot out the weather card in this instance.

Hands in too many pies

Is it possible that there's more to the story? Could it be that Canadian Tire executives have overextended themselves with the \$985 million Helly Hansen acquisition?

I'm not talking about the financial cost of the acquisition — the most significant in the company's storied history. I'm referring to the fact that acquisitions often take a company's eye off the day-to-day operations, as it diverts considerable human resources to both closing the deal and integrating it into the existing business.

Helly Hansen products aren't expected to make their way into the stores until fall 2019. A lot can go wrong in the world between now and then.

So, why would Canadian Tire enter a partnership like the one with Petco when the financial and operational implications of dropping the ball on the Helly Hansen launch are far bigger?

I'm not sure Canadian Tire customers would miss Petco's Whole Hearted premium pet food if they didn't enter the stores until after Helly Hansen's successful launch in a year from now.

So, why do it?

The only thing that I can think of, other than it's another solid brand name to sell in its stores, is that Canadian Tire is testing the waters for a full-scale launch of Petco stores in this country.

After all, the thinking goes, if Petco's products sell well in its stores, why not partner with the U.S. company to open stores north of the border? Right now, as it stands, PetSmart owns the Canadian market along with Pet Valu and Global Pet Foods.

In April, I'd [suggested](#) that Canadian Tire shareholders ought to very worried about the first store opening by French sporting goods giant Decathlon, arguing that up until now, Sport Chek hasn't had any real competition.

Perhaps, and this is mere speculation, Canadian Tire knows this is the case and is proactively taking action to ensure that any future sales decline at Forzani's various labels due to Decathlon's presence are offset by a new brand to operate alongside Sport Chek and Mark's.

Its stock is cheap(er)

After Canadian Tire's recent correction, it trades at just less than 12 times cash flow. By comparison, **Aritzia Inc.** is trading at less than 14 times cash flow. Canadian Tire's banners are all growing same-store sales at mid to low single digits, while Aritzia is growing at double digits.

There's no question which stock should get a higher multiple.

I believe Canadian Tire is a stock to be held in most buy-and-hold portfolios. However, do not be surprised if its stock faces increased volatility over the next year, as it prepares for a world post-Helly Hansen.

Is Canadian Tire overextended? We'll find out soon enough.

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