



Should Investors Steer Clear of Retail Stocks?

Description

From a big-picture perspective, I think it's fair to say that the consumer is in jeopardy, and that future sales growth will probably pale in comparison to the last few years, as [consumer debt](#) remains at record high levels and [interest rates](#) continue to rise.

Let's look at recent earnings results from three top Canadian retailers to get a picture of the current health and the future of retail stocks.

Canadian Tire ([TSX:CTC.A](#))

With one of the most recognizable brand names, a long history, and \$13.5 billion in revenue, Canadian Tire has an unrivaled position in the Canadian retail industry.

It offers a diversification that is unmatched by Canadian retailers and will probably be less affected by a downturn in consumer spending.

But Canadian Tire stock is down 3% year to date and 12% from its summer highs.

After a disappointing first half of 2018, recently reported third-quarter results are a testament to the company and its brand, with better-than-expected results and a dividend raise pleasing investors and demonstrating the stock's value proposition.

But while same-store sales growth at Canadian Tire picked up in the third quarter, these growth rates are well below growth rates seen in recent years, reflecting an increasingly difficult environment.

Drilling down deeper, beyond simple sales growth numbers, we see a very positive trend in returns.

According to Canadian Tire, return on invested capital was 8.9%, a level that has been increasing nicely from 2014 levels of below 8%.

Sleep Country Canada Holdings ([TSX:ZZZ](#)) stock has plummeted 34% year to date, as the company has also seen slowing sales growth.

Bright spots in the quarter include stronger margins, an increase in the company's faster-growing accessories business, and a more than doubling in e-commerce sales.

And the long-term outlook is still favourable for Sleep Country.

A key reason is because with Sears Canada's demise, what was once its biggest competitor is now gone, and Sleep Country has scale and positioning to capture a big portion of these sales that are up for grabs.

Sleep Country has more than 25% market share in this market that is highly fragmented, so there is a real opportunity for continued consolidation.

Indigo Books and Music ([TSX:IDG](#))

Like Canadian Tire, Indigo also a more diversified business than many Canadian retailers.

With Indigo being positioned as the department store of the future, and given the shake-up in the Canadian retail industry, we can see that there is demand for something different.

With newly renovated stores continuing to deliver strong same-store sales growth, and continued strong online growth, the company is capturing market share at a feverish pace.

The retailer's U.S. expansion is moving forward, with the first U.S. store open in New Jersey.

This presents a big risk but also big potential return, and given that the company is moving slowly with this expansion, the hope is that the risk is minimized.

Recent results show a decline in revenue as a result of store closings and renovations, but excluding this, sales increased marginally in the quarter.

In summary

It is clear that the retail landscape has become more challenging, but it is also clear that there are some good Canadian retailers out there.

Choose your entry points wisely.

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2. TSX:IDG (Indigo Books & Music)
3. TSX:ZZZ (Sleep Country Canada)

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Date

2025/08/16

Date Created

2018/11/14

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