Bargain Hunters: Why Canadian Tire (TSX:CTC.A) Makes a Good Value Play

Description

There are few companies more Canadian than **Canadian Tire** (TSX:CTC.A). But while Canadian Tire the *brand* is cemented within the heart of Canadian identity, Canadian Tire the *stock* has seen better days. Since the beginning of this year, Canada's retailer has fallen off the highs it made in August; it's currently trading at 2017 levels. However, even with the risks associated with this iconic name, the current valuation and share-buyback program is too hard to ignore, and Canadian Tire is a good fit in any value investor's portfolio.

Brand loyalty remains strong, but is it enough?

Few companies enjoy better brand recognition than Canadian Tire, and so far, the company has been able to leverage its name to stave off competitive pressures from **Amazon** and other web-based/omnichannel retailers through its proprietary credit card and rewards programs. On the surface, it would appear that its initiatives have been successful, as evident by an increase in the average number of accounts with a balance to approximately two million, up from 1.9 million in the first quarter of 2018, and the average account balance increasing to $2,930 from $2,838 over the same period.

However, if the Bank of Canada is to be believed, average Canadian household debt of 178% of disposable income is the number one domestic financial vulnerability facing the economy, and Canadians should be (and are) deleveraging their balance sheets, while economic pressures, such as lowered consumer spending and slowing GDP growth, will also add downward pressure on Canadian Tire's financial services segment in the coming quarters.

Furthermore, another cause for concern in credit segment revenues in Q1 pointed to an increase in past-due accounts of 2.83%, up 11 basis points from last year. Although it remains to be seen if this uptick was a one-off, further increases in past-due accounts should raise some questions, especially if we combine it with slowdowns in loan growth.

Then there is the SportChek issue. As you might be aware, SportChek is Canadian Tire's big-box sporting apparel brand, and for the past 12 quarters, this segment has largely done nothing. Sales per square feet of store space has been relatively flat for the past two years, and as we all know, mall and brick-and-mortar traffic continue to face dwindling consumer interest. Moreover, sporting goods and apparel would be the most vulnerable to intensifying retail competition — not only in physical storefront by also in the e-commerce channel.

In other words, I would place SportChek as the second-biggest overhang on Canadian Tire's stock, especially as this segment makes up approximately 24% of total retail revenues on a trailing 12-month basis. And yes, while bulls can point to the increases in same-store growth across the retail segment, note that these numbers are subject to overstatement, as Canadian Tire includes e-commerce sales in this metric. This means that if you buy an item on Canadian Tire's website and schedule to pick it up in store, the sale will be attributed to the store.

Despite the risks, a value proposition can be made

Conversely, if you believe in the longevity of Canadian Tire's brand identity and the economy to rebound in the second half of this year, the current share price makes for a good value play. Currently, the stock is trading at roughly 8.4 times trailing EBITDA, or a decent haircut from its usual nine times earnings.

Canadian Tire is a serial dividend grower and has an outstanding buyback program that will run from this year to the next, which will take approximately 10% of the outstanding float off the market.

In other words, if you are a value-oriented investor, Canadian Tire is certainly a buy at these levels, and you will be paid (and hopefully rewarded) for your patience; however, if you are growth oriented, your money will be better parked elsewhere.

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