Is This Famous Short-Seller Right About Canadian Tire (TSX:CTC.A)?

Description

You might remember Steve Eisman from *The Big Short* book and movie of the same name. He made himself a legend in the investing world by making a fortune shorting collateralized debt obligations leading into the 2008-09 housing crisis.

Since then, however, Eisman's track record has been a little bit spotty. While he has had some successes shorting stocks — including a bet against U.S. for-profit education back in 2010 and, more recently, a bet against automaker **Tesla** — he has also made some predictions that didn't work out so well.

For instance, Eisman has been bearish on Canadian housing since 2013, maintaining his call while property values across the country kept marching higher.

Eisman's newest target is one of Canada's more iconic companies. Let's take a closer look.

The new big short?

While speaking with *Business News Network* recently, Eisman disclosed his newest short position in Canada — **Canadian Tire** (TSX:CTC.A).

Primarily, Eisman is concerned with Canadian Tire's financial services division, a part of the company I highlighted as risky months ago. He told anchor Catherine Murray: "they have a fairly significant credit card portfolio, which — if I'm right about the credit in the Canadian banks — eventually those problems will show up in Canadian Tire's credit card business."

Essentially, Eisman is saying Canadian Tire is increasingly levered to the Canadian consumer, and a recession will hit the retailer's financial services arm especially hard. Remember, when times are tough, unsecured credit — like credit cards — are the first thing the average consumer will stop paying.

Eisman also thinks Canadian Tire will feel pressure from other online retailers, especially **Amazon**. "I think the last two quarters they've had some real margin pressure," he told Murray. "I think the reason for the margin pressure is they're feeling the heat from Amazon."

Through the first two quarters of 2019, Canadian Tire reported gross margins of 32.6%. That's a mere 0.34% decline in gross margins reported in the same period last year. The company easily made up for that small decline by increasing retail sales by 2.1% so far in 2019. The company is also being aggressive online and highlighted excellent growth in Sport Chek's online store recently. So, I'm not sure the Amazon threat is as pressing as Eisman thinks.

Canadian Tire's response

David McCann, Canadian Tire's CFO, went on *Business News Network* to respond to Eisman's short position.

He acknowledged Canadian Tire's credit card portfolio would be impacted in a recession, saying "any business in the credit business will get hit somewhat [in a recession], I just think we'll outperform others in that particular scenario."

But he also spoke about the strength of that particular part of the business, pointing out the steady growth in credit card receivables, despite a terrible recession in 2008-09 and a much more mild recession in 2015. McCann also highlighted that the retailer has years of experience judging credit risk and has put a great deal of thought and effort into reducing those kinds of risks.

Ultimately, McCann summed it up as follows: "I'm a dark cloud guy generally speaking, but at the end of the day we don't see any evidence in our portfolio of consumer challenge."

Which side should you believe?

Canadian Tire shares are trading at close to a 52-week low, which immediately tells me many of the risks Eisman spoke about are already priced into the stock. If these risks deteriorate, shares could easily dip lower.

But it's also incredibly hard to short stocks. You must get the thesis right along with the timing. Besides, Canadian Tire is putting up excellent numbers. So far in 2019, the company has nicely improved both its top and bottom line. Does that sound like the kind of company you want to short?

At the end of the day, I believe Canadian Tire will see weakness in the credit card division during the next recession. But getting the details right is too difficult for the average investor. Eisman might end up being right, but ultimately it's a risky move trying to join him in this trade.

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