Why Canadian Tire (TSX:CTC.A) Stock Fell 1.15% in August

Description

Shares of **Canadian Tire** (TSX:CTC.A) lost 1.15% last month despite the major headline that the company will acquire Party City and the strong retail sales growth reported in the company's second quarter earnings release on August 8.

Canadian Tire announced plans to purchase Party City for $174.4 million, which includes approximately $40 million in merchandise. Party City has 65 retail stores throughout Canada, 10 manufacturing facilities, and relationships with over 1,200 suppliers.

A booming industry

Party supplies in Canada represent an industry of almost $2 billion. With the acquisition of Party City, Canadian Tire becomes the largest party supply retailer in the country. The purchase also provides Canadian Tire with exclusive licensing and direct-to-retail relationships with brands like **Disney** and Marvel.

Although the display of Party City's merchandise will vary by location, most Canadian Tire stores will incorporate dedicated aisles to showcase the party supplies. Party City's entire inventory will be available on Canadian Tire's e-commerce site.

Consumer brands

Canadian Tire carries 15 distinct consumer brands, each with annual revenue over $100 million. The brands are carried at Canadian Tire stores and its subsidiaries, including SportChek and Marks.

In the second-quarter earnings release, the company reported that sales from these brands rose 7% for the quarter. Revenue from one of the most successful brands, Helly Hansen, is up 63% for the quarter. Its year-to-date sales are over $39 million.

SportChek and Mark's both showed growth for the quarter. SportChek, where the company's consumer brands represent 11% of sales, had its fourth consecutive quarter of growth, up 3.7%.

Despite the cooler spring temperatures, Mark's also showed revenue growth, up 2.6% for the quarter. Canadian Tire's auto service rose 3.5%.

Declining profit margins

Despite strong growth in retail sales, Canadian Tire's profit margins declined for the quarter. The company attributes the drop to slower sales in high-profit seasonal products, most notably at Marks.

The strong performance of the company's lower margin products, including the company's Living brand, was not enough to offset the poor performance of higher-margin merchandise.

Gross margin in the Petroleum business was down over $7 million due to the tougher environment in the industry and the newly introduced carbon tax. The company also faced higher interest costs from the debt on capital required to purchase the Helly Hansen brand.

Headwinds in credit

Canadian Tire maintains a Triangle Rewards program, which allows members to collect and redeem rewards for shopping at its subsidiaries and partners. The program offers three Mastercard credit cards specifically designed for Canadian Tire's customers.

The number of accounts rose 4.3% for the quarter and the average balance increased 3.8%. But with the average consumer debt in Canada on the rise, retailers offering credit cards could face headwinds if the Canadian economy takes a downturn.

Famed investor Steve Eisman from *The Big Short* recently disclosed a short position in Canadian Tire. Eisman is especially concerned with Canadian Tire's financial services division, noting that the retailer is increasingly tied to the Canadian consumer. According to Eisman, any recession will dramatically impact the retailer's financial services arm.

The bottom line

Canadian Tire seems to be bucking the trend for retail, showing strong results for the quarter. The addition of Party City will give the retailer a more diversified product offering and add to the growing list of consumer brands the company offers.

However, any downturn in the economy would hurt the company, especially its financial services business. Its retail arm would also suffer, as many of its products qualify as discretionary spending, which would certainly decline in a recession.

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