Investor Beware: A Short-Seller-Targeted Stock to Avoid!

Description

Canadian Tire (TSX:CTC.A) is being shorted by one of the most famous short-sellers out there, Steve Eisman, the man made famous by his *Big Short* on America's housing market prior to its 2007-08 collapse.

Eisman has taken a break from his bearish comments targeting the "ill-prepared" Canadian banks to comment on Canadian Tire, which he believes could be headed for a further spill, thanks in part to its vulnerable position as a brick-and-mortar retailer and its credit card business — potentially a real sore spot for the company as credit normalizes.

In a prior piece, I commented on Canadian Tire's aggressive pursuit of getting store patrons to sign up for its credit card:

"If you've ever been to a Canadian Tire, Sport Chek, or a Marks, you've probably had folks aggressively trying to get you to sign up for a Canadian Tire credit card right in the middle of the store with the promise of discounts on goods that you intend to buy," I wrote.

"…by targeting random consumers in your store with the promise of a few bucks off a pair of shoes, you're just asking for a loan book of less-than-stellar credit quality."

While the magnitude of the damage will be less severe than that of a Canadian bank, as it's easier to default on a mortgage than on a pair of shoes, I ultimately think that Canadian Tire's approach to growing its credit card business will hurt the company in more ways than one.

It's not the credit card business that I'm worried about, however. Rather, it's the degradation of the in-store experience for customers who don't want to be pressured to sign up for a card when all they want is a quick pick-up from the local Sport Chek.

For brick-and-mortar retailers, the experiential factor plays a huge role in whether customers, particularly millennials, will return.

As competition from Canadian Tire's e-commerce competitors picks up, Canadian Tire needs to bolster its in-store experience and not deter folks in order to build its credit card book by tempting Canadians who are already deep in consumer debt.

While Canadian Tire has made meaningful progress with its digital platform, the retailer will always remain a brick-and-mortar player at heart, and with a seeming lack of direction, I do believe that Canadian Tire's margins could continue to erode.

The acquisition of exclusive brands could beef up margins over the near term, but if you can't give consumers a reason to go into stores, it's going to be tough to remain competitive.

As such, I see margins continuing to downtrend over the long haul unless Canadian Tire can get make a big splash in the hardware business, as I suggested in a prior piece.

I used to be a big fan of Canadian Tire, but Eisman's points have me convinced. Moreover, I don't like the direction that management is headed with the acquisition of branded merchandise that can easily be shipped online.

Canadian Tire needs to double-down on large items that don't make sense to ship and become more like a Home Depot if it's to reverse its multiple compression.

The stock trades at 10.5 times forward earnings and 0.65 times sales, both of which are lower than the company's five-year historical average multiples of 13.8, and 0.8, respectively.

Although seemingly cheap based on such valuation metrics, investors need to realize that the competitive landscape has changed and the fundamentals aren't as attractive as they used to be.

I'd avoid Canadian Tire until either shares trade at much lower multiples or management makes moves to get into the hardware business, something I find unlikely at this juncture given the potentially high price tag.

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joefrenette