Investors: This Iconic Canadian Stock Just Got Too Cheap to Ignore!

Description

The past few months have witnessed a softening economy that has hit many stocks hard.

Although earnings are broadly still growing, stocks have been flat for most of the summer, resulting in many getting cheaper relative to earnings. Transportation stocks in particular have gotten cheap after falling dramatically, despite only modest slowdowns in earnings. The same can be said of other individual stocks in a wide variety of different industries. One iconic Canadian retail company has gotten particularly cheap recently — but, as you're about to see, that doesn't necessarily make it a buy.

Canadian Tire

Canadian Tire (TSX:CTC.A) is a retail stock best known for selling automotive, sports, and home products. Recently, the company has branched out into clothing after acquiring the sportswear company Helly Hansen. The company has grown steadily over the decades — although recent years haven't been as frothy as past ones. Over the past three years, the company has increased its net income from $659 million to $692 million — an annualized growth rate of about 1.62%.

Broadly speaking, CTC's stock performance has been solid. Since October 2006, it has risen 106% compared to only 37% for the TSX. However, the stock has been doing poorly over the past month, falling about 2.85%. As a result, it has become cheap, with a P/E ratio of just 12.89.

Why it has gotten so cheap

There are several reasons why Canadian Tire shares have gotten cheap. One reason is that, although the company is growing, its growth has been pretty slow over the past few years. Canadian Tire has arguably saturated the Canadian market for its particular niche, and its clothing acquisitions don't seem to be powering huge revenue gains. As mentioned, earnings have only grown by about 1.62% annualized over the last three years. In the most recent fiscal year, earnings actually declined 0.3%. This isn't exactly frothy growth, although the fourth quarter of 2018 was pretty strong, with diluted EPS up 16.6%.

Another reason that Canadian Tire has been getting hit is its exposure to the credit market. The company is as much a financial services company as a retailer now, with a lineup of credit cards that it's increasingly relying on for growth. In 2018, the company's financial service revenue grew 8.9% for the full year compared to 5.5% growth in overall sales. This means that credit cards are an above-average revenue driver for the company.

Unfortunately, the Canadian credit market has been weak lately, and exposure to credit card receivables could harm the company. Hedge Fund giant Steve Eisman has been sounding the alarm about Canadian credit quality in recent years, citing it as a reason for his short thesis against Canadian banks. He has a similar thesis about Canadian Tire, saying that its dependence on credit card receivables could hurt it, as more and more Canadians default on their debts. Nobody knows exactly how bad the average Canadian's credit score has gotten, as that info is not public. However, banks have been increasing their provisions for credit losses in recent quarters, suggesting that the alleged decline in consumer credit quality is indeed real.

Foolish takeaway

With a P/E ratio of 12.89, Canadian Tire's stock has gotten too cheap for a value investor to ignore. However, that doesn't make it an automatic buy. The company's earnings growth has been slow in recent years, and increasing reliance on financial services could spell trouble down the line. This stock may be worth buying as a pure dividend play (it yields 2.88% with steady earnings and a 35% payout ratio), but it won't likely see huge gains.

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Date
2025/07/08
Date Created
2019/10/23
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