Warning: This Canadian Icon May Be Skating on Thin Ice

Description

Canadian Tire (TSX:CTC.A) stock has been treading water over the past year. The Canadian icon is starting to feel the heat from increasing competition. With a 3% dividend yield close to the highest it's been in recent memory, income investors have an incentive to go against the grain. Still, I'd encourage them to look at the road ahead for the company to ensure their investment in the name doesn't end up blowing a tire.

At the time of writing, Canadian Tire shares are down about 14% from their all-time highs and up 18% from its late-August trough. The recent strength in the Tire was courtesy of third-quarter results that were a lot better than feared.

In a prior piece, I'd urged investors to look beyond the decent results (EBITDA margins improved to 15.5%) and the encouraging news (operational efficiencies to drive $200 million in savings by fiscal 2022).

"Sure, operational improvements are great, but they don't address the underlying problem of Canadian Tire's pressures," I said. "There's only so much juice you can squeeze out of a lemon, and once there are no further efficiency improvements to be made, the company will need new answers to achieve the magnitude of earnings growth it's posted in the past."

At the time of writing, Canadian Tire stock trades at 13.9 times trailing earnings, which I think is pretty expensive for a brick-and-mortar retailer whose revenues could be facing a squeeze.

Canadian Tire's recent bout of acquisitions and partnerships will undoubtedly help give margins a boost, but the ultimate pressure point that needs to be dealt with is the top line.

As you may know, Canadian Tire has done an impeccable job of getting customers to come into its stores. Whether it's treadmills, holograms, and attractive layouts in Sport Chek or exclusive merchandise available at Mark's, there's no question that management has killed it on the experiential factor.

To keep customers rolling in, though, Canadian Tire needs to give customers a reason to prefer it over the ever-increasing competition, both in the digital and physical realms.

To the benefit of Sport Chek, Canada's sporting goods scene has been relatively quiet in the past. But that could change with a behemoth Décathlon, which recently announced new stores to be opened in Halifax and southern Ontario. As the largest sporting goods retailer in the world, Décathlon could be a severe threat to Sport Chek's top and bottom line. Unfortunately, new and exclusive merchandise may not be enough to stop the bleeding should Décathlon further increase its footprint across Canada.

I'm not even going to mention the challenges that e-commerce competitors will continue to pose to Canadian Tire. All I know is that the road ahead looks a heck of a lot rockier than the one that lies behind the Canadian icon.

Given the added risks and uncertainties, I'd urge investors to command a more significant discount on the name at this juncture. Over the next few months, we may get such a discount, and Canadian Tire may sport a 4% yield that could make it worthy of picking given the known pressures.

I'm afraid that management had put its hand in too many pies. As a former shareholder, I grew frustrated with the company's direction and subsequently decided to throw in the towel. I may be discounting management's abilities to overcome the coming competitive pressures. But for now, I'll be joining many who will be cheering from the sidelines.

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