



Shutdown: What Happens to Canadian Tire's Stock Now?

Description

Canadian Tire ([TSX:CTC.A](#)) stores across Ontario have been shut down this week. Part of the province's response to the ongoing COVID-19 pandemic, the stores are no longer deemed "essential" services. This will ultimately impact the company's bottom line and valuation.

Investors need to consider the impact and figure out whether the stock is worth buying or selling at its current price. Here's a closer look at Canadian Tire's valuation.

Impact of shutdown

Canada's most populous province shutting down stores can't be great for Canadian Tire. The company said its online store remains open for delivery. Meanwhile, items can also be picked up from the curbside. However, it seems unlikely that the company can avoid a dent on its top line this quarter.

The shutdown could go on for weeks, if not months. Investors have no way of knowing for sure.

Aftermath

However, the current shutdown isn't the biggest issue facing Canadian Tire. Indeed, hardware stores across the country have benefited from a booming housing market and a vibrant economy that's been accelerating in recent years. Now, economic conditions have changed drastically.

Unemployment has hit a historic high while consumer confidence has dropped to a historic low. I believe social distancing will help us flatten the curve of COVID-19 infections soon, but the economy could take much longer to heal. Canadian Tire's future cash flows could thus be noticeably lower. Consequently, the valuation needs to be adjusted.

Canadian Tire's valuation

At first glance, Canadian Tire seems like an undervalued opportunity. The company owns a real estate portfolio, has robust brands and decent profit margins.

However, the balance sheet throws its valuation into disarray. At the time of writing, the company has \$9.63 billion in long-term debt that's 1.74 times the value of its equity and nearly double its market value.

In fact, U.S.-based short seller Spruce Point Capital Management has argued that the company has far more debt than reported. When lease obligations, dealer loan guarantees and third-party bank guarantees are accounted for, the debt load is much higher.

Meanwhile, the retailer's commercial real estate portfolio could lose value as the shutdown persists. In other words, the company's book value could deteriorate just as its cash flow is diminished, making the debt burden heavier.

Canadian Tire could find itself at the epicenter of a dual shock. A commercial mortgage crisis could reduce the value of the company's assets. Meanwhile, a corporate credit crisis could make its debt toxic. I believe cautious investors should stay away.

Bottom line

Canadian Tire was already the target of short sellers. Too much debt and a vulnerable retail business model made the stock risky. Now, lingering issues have magnified. The shutdown could last weeks or months more. Meanwhile, Canadian Tire's debt burden becomes heavier as cash flows have evaporated.

All the [compelling reasons to buy the stock](#) have now faded away.

If you hold the stock in your passive income portfolio, consider lowering your exposure. If you don't and are seeking a bargain in this market crash, I would recommend looking elsewhere. Stay safe!

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Date

2025/09/07

Date Created

2020/04/11

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