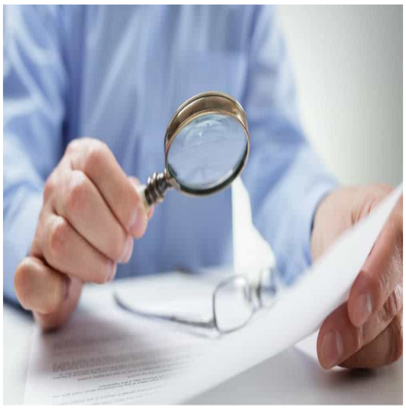

Canadian Tire (TSX:CTC.A) Looks Overdue for a Pullback

Description

Canadian Tire (TSX:CTC.A) has done a far better job of weathering the coronavirus storm than most other brick-and-mortar retailers out there. While the iconic Canadian retailer has undoubtedly felt the impact of the coronavirus crisis, the firm has done a stellar job of holding its own as a discretionary physical retailer that's essentially sitting at ground zero of this crisis.

The company boasts an incredibly strong balance sheet alongside a beefed-up e-commerce platform that's been doing a lot of heavy lifting amid COVID-19 lockdowns. Having demonstrated its resilience in the first half of 2020, there's no question that investors are feeling more comfortable in the name as we head into the second wave that could send us back into lockdown for the winter months.

I've been a raging bull on Canadian Tire following the catastrophic 52% peak-to-trough implosion suffered back in the first quarter. I'd noted that Canadian Tire wasn't built like most other physical retailers, and that shares would come flying back in the second half in a return to semi-normalcy that would see many of its brick-and-mortar locations (such as Sport Chek and Mark's) reopen to meet the pent-up demand for various discretionary goods that was built during lockdown.

Tremendous resilience … for a brick-and-mortar retailer

Canadian Tire's e-commerce platform, which was slammed by short-sellers just over a year ago, enjoyed an unprecedented boom amid the worst months of the pandemic, with sales surging a whopping 400% during the pandemic-plagued second quarter. In a second or third wave of COVID cases, I suspect Canadian Tire's ever-improving digital platform will continue to play a major role in keeping the firm from suffering the dire fate of many other less-liquid retailers that will be skating on thin ice.

Heck, Canadian Tire is a retailer that could find itself in a position of strength coming out of this pandemic, as the physical retail scene becomes that much less crowded. As bullish as I am on Canadian Tire's ability to weather the pandemic, I can't say I'm still a fan of the valuation after shares nearly doubled off its March lows.

Canadian Tire is a great retailer that's proven its doubters wrong, but now that shares are within 7% of pre-pandemic highs, I'd urge investors to take a bit of profit off the table, as shares may be a tad too expensive given the potential for further disruptions to the retailer's operating cash flows. While I don't suspect shares of Canadian Tire to make a return to their 52-week lows, I think a modest correction could be in the cards, as the risk/reward ratio no longer looks attractive in the face of a second wave.

Canadian Tire stock's valuation looks stretched

While Canadian Tire will make it through another wave of lockdowns, I think it'd be foolish (that's a lower-case *f*) to assume the same magnitude of resilience that was enjoyed during the first round of lockdowns. The longer this pandemic drags on, the more consumer sentiment will begin to wane, and that does not bode well for discretionary retailers like Canadian Tire.

At the time of writing, shares of CTC.A trade at 2.2 times book value and 17.7 times trailing earnings, both of which are higher than the five-year historical average multiples of 2.1 and 14.6, respectively. Yes, Canadian Tire did a top-notch job of weathering the first wave of COVID-19, but does it deserve to trade at a slight premium, given the potential for further disruption to its business? I don't think so and would look for shares to fall to $120 before considering nibbling.

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