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## Two reasons why Canadian Tire's strong rally may not last

**Canadian Tire Corp. Ltd.** investors continue to benefit from strong sales growth and increased market momentum for consumer goods stocks, but analysts caution a weak economy in Western Canada and the lower dollar are challenges facing the iconic retailer.

Shares of the Toronto-based retailer behind its namesake Canadian Tire stores, and Mark's and Sport Chek banners, are trading near an all-time high after reporting strong fourth-quarter and full-year sales growth, which led a handful of analysts to hike their price targets.

The shares are up 8 per cent so far this year and have risen by about 25 per cent over the past year, outpacing the broader market.

The big sales driver has been the company's FGL Sports Ltd. division, which includes the Sport Chek, Hockey Experts and Atmosphere brands. Analysts also see growth in the financial services business, 20 per cent of which was sold to Bank of Nova Scotia last year, and in the Real Estate Investment Trust (REIT) the company spun off in 2013.

"It's a pretty diversified retail-driven business with some nice growth and a very reasonable valuation," said CIBC World Markets Inc. analyst Mark Petrie, who has a "sector outperform" (similar to a "buy") rating on the stock and \$142 price target, which is just below the analyst consensus price target of \$143. That's also about 10 per cent above where the stock is currently trading around \$131.

Mr. Petrie is one of 10 analysts with a "buy," or equivalent rating on the stock, while one says "hold," and another "sell," according to S&P Capital IQ.

***Veritas Investment Research*** analyst ***Kathleen Wong*** has a "buy" rating and a \$156 target, citing Canadian Tire's consistent same-store sales growth and improvement in profit and margins in the retail division, as well as increasing customer numbers and bank balances in its financial services segment.

But the lower Canadian dollar, which makes the purchase of products imported from the U.S. more expensive, is expected to weigh on the shares. ***Ms. Wong*** estimates about 37 per cent of the company's imports are in U.S. dollars and expects an "immaterial" decline in the stock price due to the company's currency hedging program.

Slower growth in Western Canada, due to sharply lower oil prices, is also expected to have an impact on sales, particularly Mark's, which specializes in industrial work wear. The company said about 17 per cent of its Mark's stores are in Alberta.

"Our job is to run the business, not notwithstanding economic factors," said Canadian Tire chief executive Michael Medline, who took the top job in December, after 13 years in other executive roles at the company.

He said in an interview that Canadian Tire will do "everything possible" to avoid passing on increased costs to consumers, which could impact sales, and said that growth in Central Canada could offset weakness in oil-dependent provinces such as Alberta.

Canadian Tire is also ramping up its e-commerce business, which includes an eventual expansion to home delivery of items purchased online – a step beyond its current at-store pickup service.

“We are more confident than ever in the momentum of our core retail businesses,” he said.

The company recently set a three-year goal to grow sales by more than 3 per cent annually at Canadian Tire locations, 5 per cent or more at Mark’s and 9 per cent at FGL Sports. It also plans to achieve average diluted earnings-per-share growth of between 8 and 10 per cent over a three-year period.

Mr. Medline said the company is looking at potentially taking over “a limited number” of stores left behind by Target Corp.’s exit from Canada, if the price is right.

“If we don’t get any it’s because we didn’t think it made financial sense,” he said.

Canadian Tire is also looking to acquire other brands, but Mr. Medline said options are “few and far between.”

“We’re picky and we remain so because we know how good it feels to make a good acquisition,” he said, citing the Mark’s deal in 2001 and FGL purchase in 2011.

While the stock is cheaper than other retailers, trading at about 16 times forward earnings, some investors are wary of jumping in at today’s price.

“There’s nothing wrong. It’s just not cheap enough to replace something else” in our portfolio, says Bruce Campbell, president and portfolio manager at Campbell, Lee & Ross, who also owns other consumer stocks.

Credit Suisse analyst David Hartley has an “underperform” (similar to a “sell”) rating and a \$115 target price, citing risks with Canadian Tire’s valuation of the business by including the REIT portfolio with its other divisions.

“The sum-of-parts valuation is inappropriate given hybrid/consolidated nature of asset,” Mr. Hartley said in a note, arguing that it overinflates the value of the company’s real estate cash flows.