QV UPDATE
Weekly Commentary | February 21, 2020
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Same Information, But Different Decisions

The Canadian retail space has been home to many companies that have failed in the face of fierce competition. Examples include Target's arrival to Canada and subsequent departure less than two years later, and Hudson's Bay's recent decision to shutter its Home Outfitters locations. Retail businesses must make strategic decisions in a dynamic environment shaped by the rapid proliferation of technology, changing consumer tastes and an onslaught of new competitors. As an investor, it is interesting to watch how different management teams choose to respond to such challenges. Canadian Tire Corporation (CTC), which is held in the QV Canadian Equity Strategy, has taken a differentiated approach when responding to these evolving trends.

CTC continues to be aggressive in making acquisitions within the Canadian retail market. This is even after two failed attempts to expand into the US in the 1980s and 1990s. In 2001, CTC acquired Mark's (once known as Mark's Work Warehouse) for a purchase price of $116 million. The first reaction from investors was – what does CTC know about running a clothing retailer? Management's response was that the customer who shops at Mark's is the same customer who shops at Canadian Tire retail stores. As it turns out, CTC was correct in this assessment – the two brands have complemented each other, as shown by how often the stores are located next to each other. Revenue at Mark's has grown by 7% on average for almost twenty years, reaching $1.3 billion in 2019. CTC does not disclose profitability by banner, but the investment has paid for itself many times over if we assume even just a modest level of profitability.

Ten years later, CTC made its next large acquisition, paying $771 million for sports retailer Forzani Group (FGL) in 2011. The decision to aggressively pursue FGL was made only months after Target announced it would enter the Canadian market. The reaction around CTC entering the sports market in a bigger way was also met with skepticism. Canadian Tire retail stores were known as the place to go to buy basic skates, bikes and other sports equipment. Would they be able to operate a higher-end sports chain? The company believed it presented an opportunity for their customers to graduate from the basic offering at Canadian Tire to a more sophisticated offering at FGL, and saw it as a perfect way to access the 18-34 demographic. As mentioned previously, we don't get separate profitability numbers for FGL, but it was anticipated that cost savings from the acquisition would increase the earnings of FGL by 76%.

In addition to these two large acquisitions, Canadian Tire started a bank in 2003 and has made a number of smaller purchases, including Paderno, a kitchen retailer, and the Pro Hockey Life chain. The recent acquisition of Helly Hansen, a Norwegian company producing sports and work wear sold globally, reflected a significant focus on owning brands that resonate with customers. CTC indicated that 37% of CTC's sales in 2019 consisted of owned brands such as Denver Hayes, NOMA and Motomaster. These brands help drive people to CTC's stores because the company determines where they are sold. If you are used to buying Denver Hayes shirts or NOMA Christmas lights, you will find them at only one retailer.

CTC's strategy has really come to life in the last few years. Management has created what they call the Canadian Tire Marketplace – a collection of retail stores, exclusive brands, a credit card company and a strong loyalty program. What was once known as Canadian Tire money is now called the Triangle loyalty program, named after the Canadian Tire triangle logo. The data collected through the loyalty program and credit cards has helped CTC focus on key customers to determine their preferences and deliver direct marketing.

While we have witnessed many retailers close shop in Canada over the last number of years, CTC has expanded its presence by focussing on areas that resonate with existing customers and where it believes it has competence. There was concern for CTC in the mid-nineties when Walmart and Home Depot entered the market, and again when Target came in. Indeed, one of the most significant shifts in the retail industry – the introduction of online players like Amazon – is still playing out. However, with the same information as other retailers, we have seen CTC adapt and continue to increase its net worth. We don't know what's in store for the next 20 years of retailing but expect CTC's thoughtful expansion strategy to continue.