



"KICKING THE TIRE DOWN THE ROAD"

/ STRONG SELL OPINION /

Canadian Tire Corp, Ltd. | TSE:CTC/CTC.A



SPRUCE POINT
CAPITAL MANAGEMENT

INVESTMENT RESEARCH REPORT

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Spruce Point Has Succeeded In Canadian Shareholder Activism

Spruce Point has written four recent critical activist reports in Canada. In a majority of the cases, the share price collapse has met or exceeded our downside estimate of intrinsic value. The avg. share price decline is 57%. A common theme is that Canadian analysts don't ask difficult questions of management, challenge assumptions, and are overly optimistic.





Company:	Intertain 	TSO3 	Maxar (Formerly MacDonald Dettwiler) 	Dollarama 
Exchange: Ticker	TSX: IT	TSX: TOS	NYSE and TSX: MAXR	TSX: DOL
Report Date	December 17, 2015	August 23, 2017	Aug 7, 2018	October 31, 2018
Stock Brokers Who Said "Buy"	Canaccord/Mackie/Nat'l Bank/Cormark	Canaccord/RBC/Scotia/GMP	Canaccord/RBC/TD/CIBC/GMP/BMO/Nat'l Bank/Scotia	RBC / Raymond James / Macquarie / BMO / CIBC / Desjardins / Canaccord / Scotia
Spruce Point's Criticisms	<ul style="list-style-type: none"> Stock promotion of a poorly organized online gaming roll-up CEO FitzGerald has a checkered past with ties to questionable people Ties to Amaya, a company being investigated by regulators Management Incentive Program is flawed and unjustly enriches insiders Questionable financial reporting and accounting practices Overvaluation: 45%-70% downside 	<ul style="list-style-type: none"> Poorly promoted Canadian healthcare company, with limited product value Disclosure issues obfuscate actual end market sales, and overstatement of total addressable market Over-promotion of a partnership with Getinge that would be destined to fail Terrible insider alignment with mgmt. owning 1% of shares 80%+ downside when Getinge deal fails 	<ul style="list-style-type: none"> MDA's acquisition of DigitalGlobe driven by the need to cover problems in its satellite business, including a forthcoming decline in the geostationary satellite industry Brazen accounting scheme including inflation of intangible assets to overstated Non-IFRS EPS Dangerously levered at 5.8x when taking into account off-balance sheet liabilities make Maxar's dividend at high risk of being cut or eliminated Analyst estimates are too high, and goodwill and asset impairment looms 	<ul style="list-style-type: none"> Same-store sales growth through price increases unsustainable and sacrifices store traffic Aggressive, poorly-planned expansion into increasingly-saturated market Inexplicably high margins for a dollar store at risk to impending cost pressures Nepotistic leadership engaging in related-party transactions for family-owned real estate Buybacks and dividends supported by heightened leverage at risky levels 40% downside to C\$28/share
Successful Outcome	<ul style="list-style-type: none"> Intertain initiated a strategic review upon the report release Feb 2016, CEO FitzGerald resigns from Intertain (source) Intertain delists from the TSX in Jan 2017 and re-lists its shares in the UK -- claiming that the Canadian markets don't value its business (source) Analyst price targets of C\$28.00 were never achieved. Shares hit a low of C\$7.13, down 42% 	<ul style="list-style-type: none"> On Jan 25, 2018, TSO3 discloses amendments to the Getinge partnership, validating Spruce Point's criticisms (source) Multiple brokers downgrade shares from >C\$5.00 to C\$2.00 Share price made a low of C\$0.48 in Oct 2018, down 81% 	<ul style="list-style-type: none"> Maxar's twice attempted to "refute" our conclusions, yet its share price collapsed 90% following our report and lingers near a multi-year low Maxar took a \$386m asset write-down and impairment loss (source) Multiple resignations including CEO and Chief Accounting Officer Dividend cut to one penny (source) 	<ul style="list-style-type: none"> Same-store sales deceleration and transaction growth contraction continued into Q4, as expected Price hikes suspended in wake of customer exodus triggered by departure from dollar store pricing model Share price made low of C\$31 in Dec 2018, close to our target share price of C\$28

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Executive Summary

Spruce Point Is Short Canadian Tire (TSE: CTC) And Estimates 35%-50% Downside Risk

Spruce Point has significant concerns about Canadian Tire (TSE: CTC or “the Company”), one of the largest retailers in Canada. Canadian Tire is a challenged brick-and-mortar retailer perceived as a dependable mid-single-digit grower on an increasingly precarious foundation of unsustainable debt. CTC is facing a credit downgrade due to its misunderstood and over-levered balance sheet, which has forced it to sell profitable assets in order to continue its capital return plan. Current leverage of ~3.5x is significantly above rating agency guidance of 2.5x needed to prevent a downgrade and requires debt reduction of ~C\$1,600m, but has no free cash flow after promised dividends and buybacks. CTC’s stale brand and dated model, together with broader retail headwinds, have made its financial results dependent on aggressive accounting practices, which are potentially misleading investors by masking poor organic growth. The market is blissfully ignorant to the Amazon displacement effect that our data shows is accelerating. Recent cost reduction measures and return of capital policies to investors are ill-fated, too little and too late. Outside of retail, CT Financial Services’ is a fast growing, risky business with a deteriorating credit card portfolio. We believe CTC will begin to underperform optimistic expectations and the combination of these factors should result in a valuation at a significant discount to the market and its peers.

An Antiquated And Structurally Non-Competitive Brick And Mortar Retailer With No Clear Focus And No Competitive Advantage

- CTC’s retail footprint consists of Canadian Tire, Mark’s and FGL Sports banner stores with products ranging from automotive, tools & hardware, home goods and sports & recreation
- While SSS (same store sales) have grown modestly, we believe a significant part of the growth is not sustainable due to the declining number of stores and a rapidly saturated market
- CTC’s has no competitive advantage and often leaves customers “frazzled-looking” due to the vast stores and cluttered aisles
- The 4 P’s of marketing suggest that CTC is at a clear disadvantage in the retail market:
 - Product: Diverse assortment with no clear focus, sweet spot is mostly lower quality, mass market products (low ticket items of ~\$50)
 - Price: Not price competitive, products are often marked down on “flyer” sales, least competitive shipping fees vs. peers (no free shipping) and offering free shipping will destroy already contracting margins
 - Place: Brick and mortar business model with stores often located in close proximity, or sometimes in the same shopping center as, competitors including Walmart, Costco, Home Depot and Lowe’s. Major U.S. retailers continue to expand in Canada and gain market share. As Canadian e-commerce continues to grow, and mobile adoption increases, CTC’s business lags peers.
 - Promotion: Promotes through “old-fashion” flyers, credit card promotions and Canadian Tire Money. Weak social media presence
- Canadian Tire Gas+ is experiencing margin pressure due to increased competition in the market – we anticipate this to continue due to the ~9% discount Costco Gas offers its customers
- Website traffic and mobile app data suggest CTC is struggling relative to its peers. Website visitors are 25x more likely to visit amazon.ca and mobile app users who use Amazon’s app too has increased from 50% to 75% over the last 2 years
- Amazon’s Showroom: CTC has one of the lowest conversion rate for customers who made a purchase vs. people who visit its stores
 - E-commerce lags peers and CTC cannot match the level of investment in technology as its competitors
- Don’t Bet On Botched Acquisitions Saving CTC:
 - Helly Hansen, acquired in Q3’18, continues to underperform expectations and we believe is losing market share outside of Canadian Tire banner stores. Yet, we believe management has led analysts to believe the deal is a raging success
 - We believe the acquisition of Party City Canada will be a larger failure than Helly Hansen – Party City continues to struggle in the U.S. (PARTY shares are down 70% since November 7th, 2019) and we see no reason its Canadian business will not suffer a similar fate



Declining Organic Growth, Compressing Margins and Multiple Signs of Financial Stress

- CTC's underlying retail business is struggling and has experienced gross margin compression – CTC retail reported gross margin figures mask underlying weakness due to the addition of Helly Hansen, a higher margin business
- Recent announcement of a \$200m cost savings plan is destined to fail; management's plan was very broad, lacking tangible specifics, and reminds us of numerous failed retail turnarounds all claiming \$200m of cost savings as a magic number (Sears, JCPenney, Circuit City)
 - CTC's Executive leading the efforts has a history of failed turnarounds at BlackBerry and Celestica
- There are many signs of financial stress:
 - Rising inventory levels in dealer channels suggests a slowdown in dealers' ability to sell to end market customers
 - Receivables growth is significantly outpacing revenue growth over the past 21 months
 - Worsening cash flow dynamics as days inventory increase and days payable decline year-over-year. Further stress evident as cash conversion cycle is peaking over the last three quarters
- Dealer model highly dependent on leverage – guarantees result in increased exposure for CTC



We Believe There Is A High Probability Of A Credit Ratings Downgrade Which Is Forcing The Company To Sell Assets And Reevaluate Capital Allocation – Required Debt Reduction Of ~C\$1,600m vs. FCF Of ~C\$200m

- Multiple rating agencies have warned of a credit downgrade if leverage is not reduced. Our analysis supports the view it will be nearly impossible to deliver while maintaining current levels of dividends and share repurchases without selling assets
 - Current Adjusted Net Debt / Adjusted EBITDAR leverage: 3.45x; BBB rating by DBRS, BBB+ by S&P
 - A downgrade would result in a rating on the cusp of non-investment grade (junk) status and potentially higher cost of capital
- Management has stated its investment grade rating is a top priority but is acting in a different manner:
 - CTC has continued to buyback shares while its leverage remains above the level required to prevent a credit downgrade. Management has shown no ability to create value from share repurchases
 - CTC is also increasing its dividend by ~9% in a period where it should be conserving cash
- Forced to sell assets to delever: recent actions to conserve cash are counterproductive to accreting shareholder value
 - Divesting stake in CT REIT is dilutive to EPS and shareholder value – sell-side analysts believe this is a positive and shows CTC's financial flexibility. We believe this shows Canadian Tire needs to raise cash
 - Recent increases in disposal of investment properties also signals the Company is in need of cash to delever
- CTC was unable to fund its acquisition of Helly Hansen and Party City Canada with its current balance sheet and was required to sell down its REIT stake to finance the transactions



Major Push To Grow Credit Card Business, And Fuel Retail Sales Growth, Has Resulted In Risky Lending Practices Which Should Worry Investors And Pose A Significant Threat To Overall Credit Quality

- Credit risk is higher than traditional banks given the nature of Canadian Tire's business – CTC credit card customers are typically higher risk than traditional users. CTC credit cards are used as a mean for financing a purchase, rather than traditional use as a method of payment
- CTC Triangle Rewards Program has been an effort to boost retail sales and drive store traffic at the expense of higher risk lending practices
- While management has said *"we're not concerned about the level of risk in the portfolio,"* filings show 68% of recent loan growth came from moderate and high risk customer classifications
- Net charge-offs for "seasoned" loans is at historic highs despite the majority of high risk growth over the past 12 months
 - This is a leading indicator for an increase in future credit losses as loans begin to mature
- Delinquencies have performed worse compared to other banks over the past 2 years, a signal that should worry investors




Multiple Factors Have Resulted In Reported EPS Growth Greater Than CTC's True Underlying Earnings Growth

- When adjusting CTC's EPS for what we believe to be one-time benefits, the YoY EPS growth rates drop significantly
 - Recent benefits have helped CTC hit its EPS growth target of 10%+
 - We believe investors will be caught by surprise when this growth returns to normal levels
- Many of the EPS benefits have been a result of management's aggressive changes to its accounting practices including: altering expected credit losses by modifying model assumptions, changed estimates affecting the present value of loss recoveries and changes to the Company's depreciation method



Several Signals In CTC's Corporate Governance Policies And Insiders' Recent Behavior Should Concern Investors

- Canadian Tire and CT REIT are uniquely hiding their credit agreements from investors and keeping their debt structure opaque
- Current calculation of executive incentive compensation is not in shareholders' best interest and is not transparent to investors
- CTC's Chairwoman was a Director and a member of the audit and corporate governance committee for Hollinger leading up to its fraud
- Multiple recent insider resignations are a negative signal given the recent business struggles
- Diana Chant's, an Audit Committee member, recent ownership history at the bare minimum required as a Board member raises concerns about her trust in the future of the business – does she know something the public doesn't?

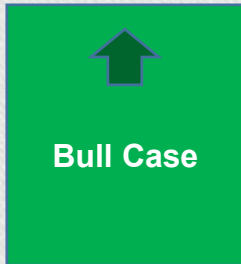


Terrible Risk / Reward Opportunity And Significant Downside To Current Share Price

- Spruce Point has a history of successfully exposing poorly positioned Canadian companies before the market realizes fundamentals have changed (eg. Maxar, Just Energy, Dollarama)
- Canadian brokers incorrectly believe CTC is a best-of-breed retailer that can withstand competitive pressures, grow 4-5%, expand gross margins ~20bps and is worth C\$167 per share (~10% upside). Analysts have priced in full credit for CTC's nebulous cost cutting program
- Based on a sum-of-the-parts value, CTC trades at a significant premium to our downside case
 - Spruce Point believes CTC's retail segment should be valued on a cash flow basis which is a more accurate representation of fair value due to the segments poor cash flow conversion and distorted "normalized" results
- CTC's declining margins and weak competitive positioning to U.S. retailers and online competitors deserves a valuation multiple at a significant discount to its peers

Spruce Point's View Vs. Consensus

With multiple Buy/Hold ratings and only one Sell recommendation, we believe the market is overlooking the most critical and material risks to Canadian Tire's business and share price.



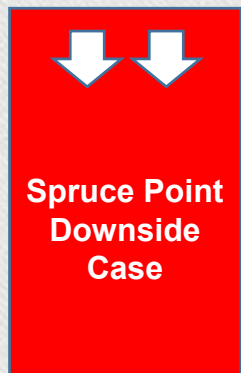
An Iconic Canadian Retailer

- Continued success of same-store-sales growth driven by private brand strategy, home delivery and store pickup and Triangle Rewards program
- Significant moat as one of the most recognizable brands in Canada
- "Tremendous financial flexibility" and ability to use capital for additional growth opportunities
- History of strong dividend growth and share buybacks
- Ability to grow e-commerce and not lose share to Amazon and others



Traditional Macroeconomic Risks Facing Any Retail Business

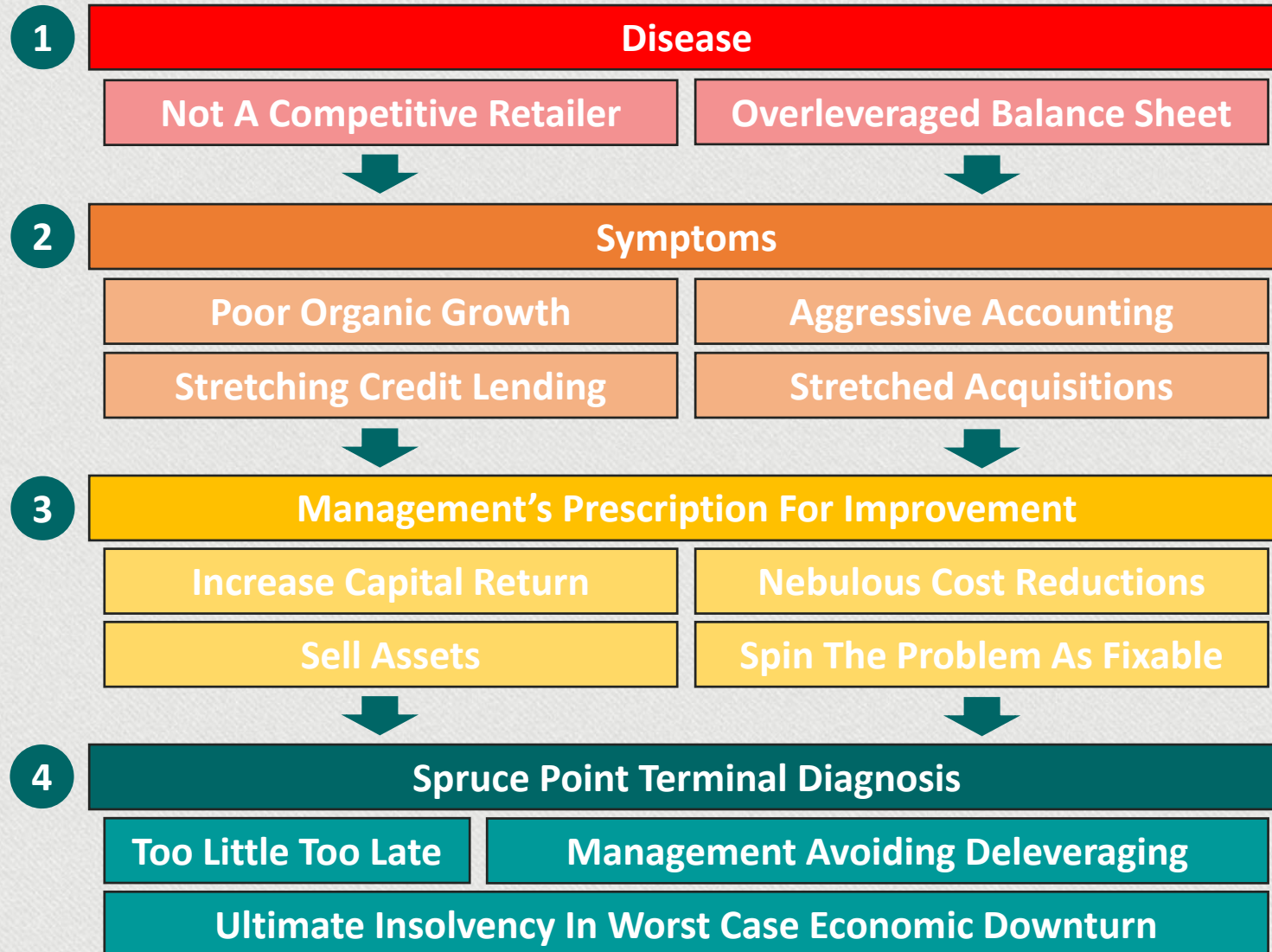
- Slowdown in macro economic environment and consumer spending
- Continue to experience margin pressure due to competition from e-commerce and other retailers
- Risk of increased delinquency rates during an economic slowdown
- Mixed questions regarding the future success of CTC's acquisition of Party City Canada
- Lone "Sell" rating by Veritas is \$127/sh



Material Risk Resulting In Significant Downside To CTC's Current Share Price

- Retailer with no clear focus and no competitive advantage, losing share at an accelerating pace to Amazon and others
- Overleveraged balance sheet will force management to choose between two evils
 - Risk of credit downgrade due to insignificant cash flow to delever
 - May be forced to sell assets and/or reduce/stop capital returns
- Various indicators signal an abnormal and growing level of credit risk in CTC's loan portfolio
- Aggressive accounting practices are masking declining organic earnings growth
- Organically declining business are showing signs of financial strain
- **Downside risk of 35%-50%**

Diagnosis Of Canadian Tire's Situation





Recent Share Price Move On Misplaced Hope

Investors have given management full credit for the cost savings plan as CTC's market capitalization increased ~C\$750 million over the following week after the announcement of the C\$200 million plan. The market appreciates CTC's steady dividend and new share repurchase program, but has temporarily forgotten about the core debt and growth challenges overhanging Canadian Tire.



The Magic \$200 Million “Rule of Thumb”


It seems a strange coincidence that many high profile retailers have announced \$200 million cost savings plans. There are many similarities between Canadian Tire, Sears, JCPenney and Circuit City. All were at one times household names, and great retail success stories. Will Canadian Tire’s story end in a similar fashion?



Sears

JCPenney



Year of cost cutting announcement: \$ in mm	2019	2018	2017	2008
 Cost Savings Plan	C\$200	\$200	\$200	\$200
Cost Savings as % of SG&A	5.8%	5.3%	5.1%	7.3%
Fate	?	Bankruptcy	Financial Distress	Bankruptcy

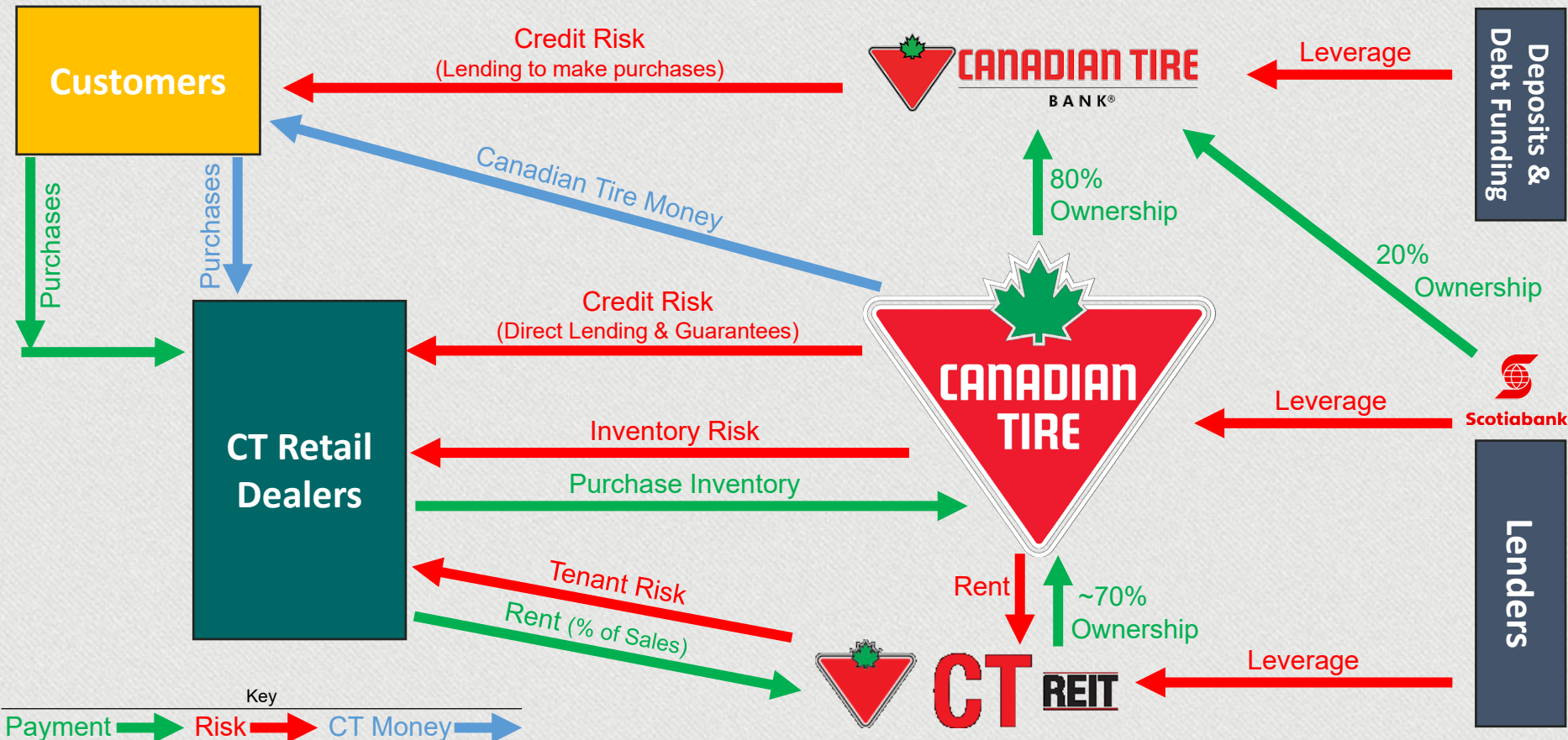


Spruce Point believes the \$200m is an identical last ditch effort seen at Sears, JCPenney and Circuit City, before things go really bad and each retailer fell into distress. Management’s proclamation that it has “*hundreds of initiatives in motion*” for cost reduction opportunities sounds comical, and begs the question, “*what has management been doing with cost programs up to this point*”?

Does The Market Fully Understand This: Overleveraged / Debt Fueled Business Model

Canadian Tire's business model is an interconnected web of risk held by Canadian Tire. The model is highly dependent on debt financing and is much riskier than a traditional Dealer model.

Canadian Tire Retail Dealers borrow (guaranteed by CTC) to purchase inventory from Canadian Tire and rent locations from CT REIT. The Dealers sell the inventory to customers financed by CT Bank Credit Cards. The customers then receive "Canadian Tire Money" rewards to spend at CT Retail stores, further boosting sales.



Significant Risk Of Credit Downgrade

We believe it will be difficult for CTC to reduce its leverage to the level necessary to maintain its current credit ratings. Equity investors and sell-side analysts are accustomed to a combination of share buybacks and dividend payments. We believe if the Company does not reduce the current capital allocated to buybacks and dividends, CTC will not have the necessary cash flow to reduce its leverage. Investors will be disappointed by the reduction in capital return plans and will be surprised by a potential credit downgrade given sell-side analysts positive view on the Company's financial position.

C\$ in mm	LTM Q3'19
Cash Flow from Operations	\$788
Change in Loans Receivable	\$336
Net Additions to PP&E	(\$351)
Additions to Intangibles	(\$217)
Payment of Lease Liabilities (principal portion) ⁽¹⁾	(\$232)
Distributions Paid to NCI	(\$78)
Payment on Financial Instruments	(\$41)
Free Cash Flow	\$205
Party City Canada Cash Flow (SP estimate)	\$4
Pro Forma Free Cash Flow	\$209
Projected Buybacks	(\$350)
Projected Dividends	(\$243)
Projected Capital Returns	(\$593)
Cash Flow Available to Pay Down Debt	(\$383)

C\$ in mm – All figures exclude financial services	
Net Debt ⁽²⁾	\$3,619
Lease Liabilities	\$2,177
Adjusted Net Debt	\$5,797
LTM Adj. EBITDA (PF for Party City)	\$1,573
LTM Rent ⁽³⁾	\$106
LTM Adj. EBITDAR	\$1,679
Adj. Net Debt/Adj. EBITDAR Leverage	3.45x
LTM Adj. EBITDAR	\$1,679
Target Leverage	2.50x
Total Net Debt Capacity	\$4,199
Required Paydown	\$1,598

Our analysis shows, **CTC does not have the required free cash flow to maintain its current level capital returns and reduce its leverage**

7.5+ years
Required to delever based on LTM FCF and assuming no return of capital to investors

We believe CTC will not be able to reduce its leverage by the end of 2020 without selling assets

1) Reported in cash flow from financing due to IFRS 16 (YTD Q3'19). Q4'18 is reflected in cash flow from operations

2) Net debt adjusted to include purchase of Party City Canada

3) Reflects Q4'18 rent expense and Spruce Point estimated Party City Canada LTM rent

Source: Company financials, Spruce Point analysis

Note: See [Section 5](#) for further detail

True Exposure Is Significantly Higher

We believe sell-side analysts are underestimating Canadian Tire's total exposure. This explains sell-side comments of CTC's strong financial flexibility while the rating agencies warn of a downgrade without reducing leverage. The most worrying factor is the lack of consistency between analysts' debt calculations. We believe the correct calculation is to consider all Canadian Tire's obligations including each controlled entity and guaranteed third party loans.

C\$ in mm	Spruce Point	TD	Scotiabank	Canaccord	CTC Reported
Bank Indebtedness	\$40	--	\$40	\$40	\$40
Short-Term Borrowings	\$910	\$910	\$910	\$614	\$910
Current Portion of Long-Term Debt	\$538	\$538	\$538	\$1	\$538
Long-Term Debt	\$3,979	\$3,979	\$3,979	\$1,200	\$3,979
Current Portion of Lease Liabilities	\$316	\$316	\$316	\$316	--
Lease Liabilities	\$1,861	\$1,861	\$1,861	\$1,861	--
Short-Term Deposits	\$830	\$830	--	--	\$830
Long-Term Deposits	\$1,667	\$1,667	--	--	\$1,667
Dealer Loan Guarantees ⁽¹⁾	\$661	--	--	--	--
3rd Party Bank Guarantees ⁽²⁾	\$415	--	--	--	--
Total Debt	\$11,216	\$10,100	\$7,644	\$4,032	\$7,963
Cash and Cash Equivalents	(\$226)	(\$226)	(\$600)	(\$600)	(\$226)
Short and Long-Term Investments	(\$349)	(\$349)	(\$349)	(\$349)	(\$349)
Financial Services & REIT Cash	--	--	--	\$442	--
Net Debt	\$10,640	\$9,525	\$7,068	\$3,898	\$7,387
Total Debt / EBITDAR	5.6x	5.1x	3.8x	2.0x	4.0x
Net Debt / EBITDAR	5.4x	4.8x	3.6x	2.0x	3.7x

\$1bn+ of guarantees not included in debt calculations

Leverage is significantly higher than it appears

Note: Q3'19 LTM EBITDAR of \$1,986

Source: Company financials, equity research reports, Spruce Point analysis

1) Dealer loans primarily relate to loans issued by Franchise Trust

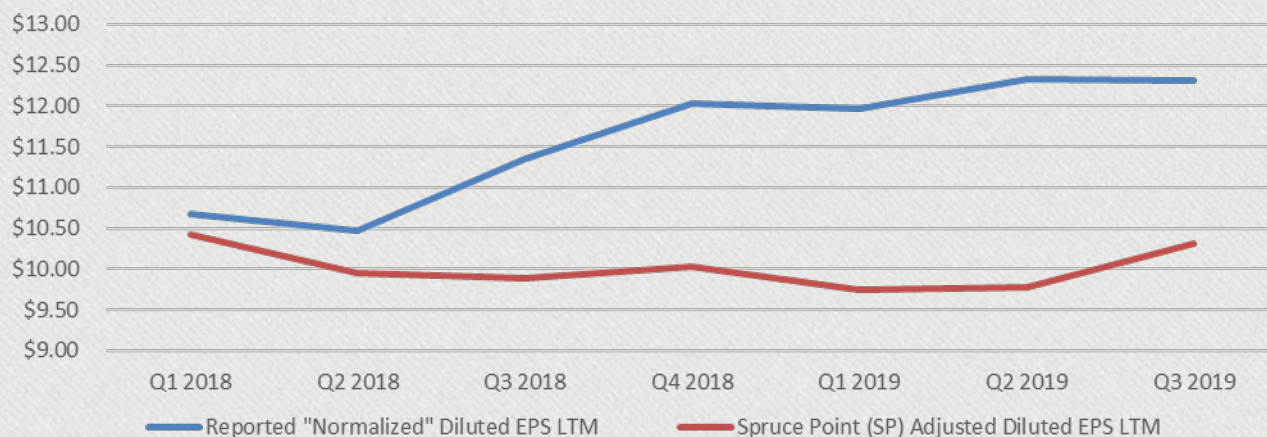
2) Guarantees of third-party bank debt agreements

Reported EPS Does Not Provide Investors With A Clear Picture Of The Underlying Growth

We believe Canadian Tire's reported EPS does not reflect its underlying organic growth.

By removing what we believe are unsustainable benefits to EPS, the gap between our Spruce Point adjusted EPS and the reported EPS widens.

Reported vs Spruce Point Adjusted LTM EPS



C\$	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019
Reported							
Reported "Normalized" Diluted EPS LTM	\$10.67	\$10.47	\$11.36	\$12.03	\$11.97	\$12.33	\$12.32
LTM Normalized EPS Growth Y-o-Y				12.0%	12.2%	17.8%	8.5%
Spruce Point Adjusted							
Spruce Point (SP) Adjusted Diluted EPS LTM	\$10.43	\$9.95	\$9.89	\$10.02	\$9.74	\$9.78	\$10.26
LTM SP Adjusted EPS Growth Y-o-Y				(6.7%)	(6.6%)	(1.7%)	(9.6%) ⁽¹⁾

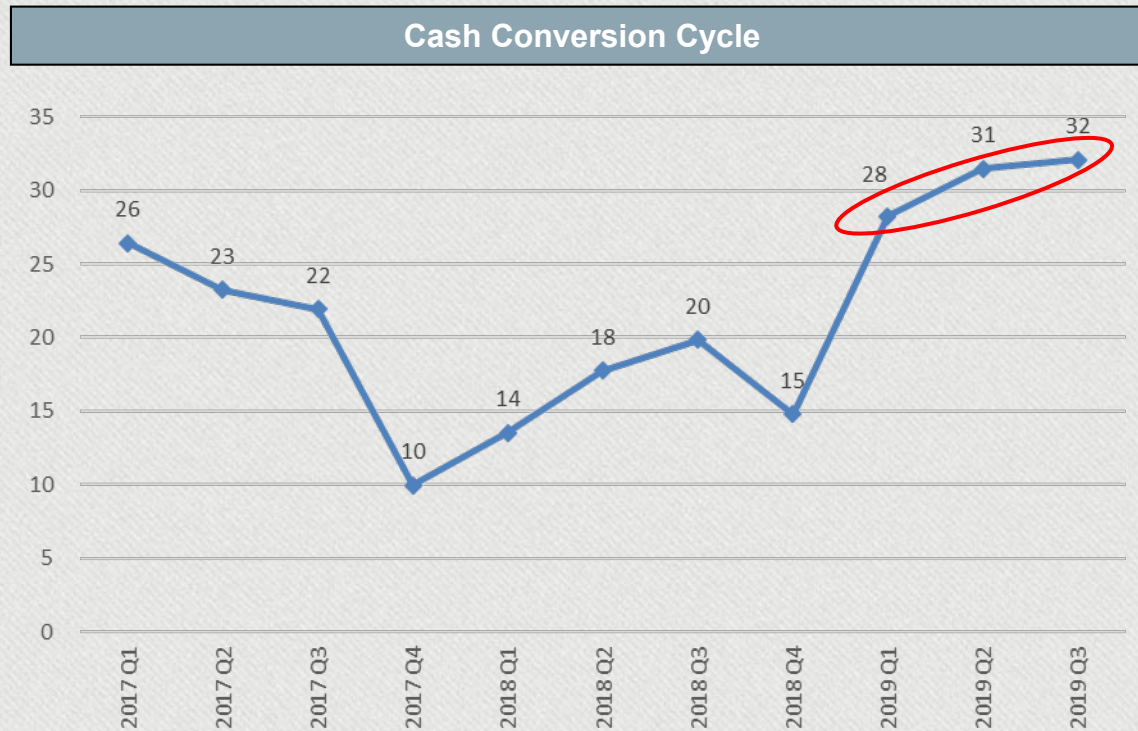
1) Growth rate based on reported Q3'18 LTM EPS

Note: See [Section 7](#) for further detail

Source: Company financials, Spruce Point analysis

Cash Conversion Cycle Deteriorating

CTC's cash conversion cycle (defined as DSO + DIO – DPO) has jumped in the first three quarters of 2019 on both a Y-o-Y and an absolute basis. This is further evidence of weakness in CTC's retail business and another sign of strain on cash flow.



Pressure From The Top To “Hit Numbers”

Canadian Tire’s CEO has stressed the importance that “hitting numbers” is a clear goal of management. Pairing his comments with CTC’s accounting changes since 2016, it seems there is reasonable motivation by management to alter historic accounting methods and assumptions in favor of increased earnings. Investors should take note of management’s willingness to use these accounting changes to influence EPS.

Canadian Tire CEO Stephen Wetmore’s Earnings Call Comments Regarding “Hitting Numbers”

Q2 2016 Call
August 4 2016

*“We always look at the numbers in the following way. That if we put great numbers up, we’re in control, and if you don’t have good numbers, then the outside world ends up being in control. **If we want to stay on our agenda, we have to continue to hit our numbers.**”*

Q2 2019 Call
August 8, 2019

*“Yes. I mean we put our aspirations out a few years ago, I guess it was, for performance and bottom line and ROIC performance. **It’s extremely important we hit those numbers**, but it was more important in our Operational Efficiency Program overall that we drove what’s necessary for our customer experience. That, bar none, had to be the number one priority both from a digital point of view and from our ability to collect data and analyze it and use it in the proper way...*

*So now’s the time. We’ve got things up and running. We feel quite confident, and so now is the time to push it, **but we have to hit those numbers**. It’s what we published and it’s how we expect ourselves to perform.”*



A Legacy Retail Business With A Complete Loss Of Focus

Canadian Tire At A Glance

Canadian Tire (CTS) is a Canadian national retailer of a wide range of automotive, hardware, sports and leisure, and home products. CTC business includes Canadian Tire Retail, Canadian Tire REIT and Canadian Tire Financial Services. CTC was founded in 1922 and is headquartered in Toronto, Ontario.

Market Data

Class A Share Price (TSE: CTC.A)	C\$151
Market Capitalization	C\$9,469
Enterprise Value	C\$17,335
Dividend Yield	2.75%

Financials

	LTM Q3'19	Margin	Multiple
Total Revenue	\$14,349	--	1.2x
Gross Profit	\$4,789	33.4%	--
EBITDA	\$1,964	13.7%	8.8x
EPS	\$11.19	--	13.5x

Credit Ratings

DBRS	BBB
S&P	BBB+
Moody's (Commercial Paper)	P-2

Retail



Number of Retail Stores	1,685
Total Retail Square Footage	33.7 million
Revenue	\$13,038
<i>% of Total Revenue</i>	<i>87.8%</i>
EBITDA	\$1,467
<i>% Margin</i>	<i>11.3%</i>

Real Estate Investment Trust ⁽¹⁾



Total Properties	345
Gross Leasable Area	27.1 million
Revenue	\$485
<i>% of Total Revenue</i>	<i>3.3%</i>
Funds from Operations (FFO)	\$257
<i>% Margin</i>	<i>53.1%</i>

Financial Services



Gross Avg. Accounts Receivable	\$6,324
Avg # of Accounts with Balance	2.1 million
Revenue	\$1,324
<i>% of Total Revenue</i>	<i>8.9%</i>
EBT	\$409
<i>% Margin</i>	<i>30.9%</i>

(1) [CTC owns 69.4% of CT REIT](#)

Note: Financial data in millions of Canadian Dollars except per share amounts. Figures LTM as of Q3 2019. Financial Services balances represents Q3 2019 average balances
 Source: Company financials

Retail: “Jack Of All Trades, Master Of None”

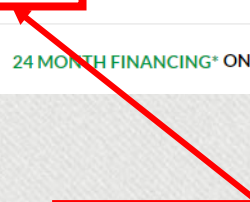
It is unclear what Canadian Tire Retail's focus is.
We believe this lack of focus is a root cause of the Company's recent retail struggles.

CANADIAN TIRE. Made for Life in Canada. | NO FEE, NO INTEREST* EQUAL MONTHLY FINANCING AVAILABLE. [Learn More](#)

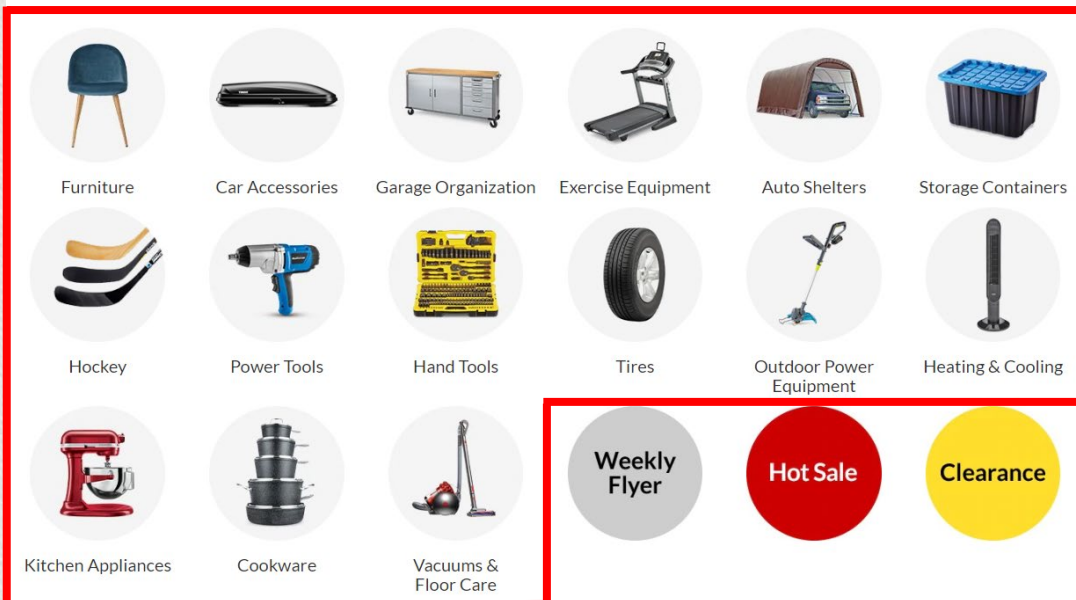
Sign In Français














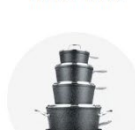

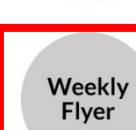
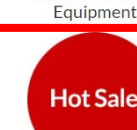
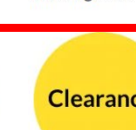
GANANOQUE, ON 8:00 am - 8:00 pm What are you looking for today?

AUTOMOTIVE TOOLS & HARDWARE HOME & ESSENTIALS SPORTS & RECREATION OUTDOOR LIVING FALL PREP HOT SALE



FEATURED CATEGORIES



 Furniture	 Car Accessories	 Garage Organization	 Exercise Equipment	 Auto Shelters	 Storage Containers
 Hockey	 Power Tools	 Hand Tools	 Tires	 Outdoor Power Equipment	 Heating & Cooling
 Kitchen Appliances	 Cookware	 Vacuums & Floor Care	 Weekly Flyer	 Hot Sale	 Clearance

What is Canadian Tire's focus?

It is unclear given Canadian Tire is basically a one stop shop for everything

Auto, tools, home goods, furniture, pet care, sports, exercise, outdoors and so much more!

However, there are specialty retailers and online alternatives to compete with

Not A New Problem

Canadian Tire has lost focus on its core automotive business. In 2009, the Company planned to refocus on its roots but its business has not changed and its product offerings continue to grow.

Maclean's Article (October 11, 2011)

Canadian Tire's baffling strategy to sell you everything

It breaks every marketing rule, but it's paying off

Maclean's
Article

The main Canadian Tire store in 1937 (complete with roller-skating stock boys)—is **not a very welcoming place these days**. Prospective shoppers are greeted by a queue of **frazzled-looking customers** clutching humidifiers and extension cords at the service counter. They must then negotiate a pair of waist-high turnstiles before browsing aisle after **cluttered aisle of merchandise as varied as Canada's seasons**: kitchen utensils, vacuum cleaners, caulking guns, drill bits and sprinkler attachments. Upstairs there's hockey gear, camp stoves, some toys and cans of tennis balls. Downstairs, auto parts, oil-slicked service bays and, finally, a wall of all-season tires.

Newer stores, located in towns and cities across the country, are brighter and more airy, but **largely house the same eclectic inventory—none of it particularly cheap and none of it terribly aspirational either**. Customer service, meanwhile, **varies wildly from store to store**, the result of the **company's independent—and bureaucratic—dealer ownership model**.

Jim Danahy

CEO

CustomerLAB
(Retail Consultant)

"Canadian Tire **needs to be careful it doesn't stray too far from its bread and butter**... that means being a store where Canadians can buy the items on their household to-do lists... Their customers did not accept them as a major home decor player. They accept them as good for paint, good for small appliances, the most basic of lamps and cheap furniture."

2009 Annual Report (page 3)

Message
from the
Chairman

We will also be very **focused** on achieving a better return on invested capital for our retail businesses, in effect, getting more from our existing assets. And we will **refocus on our automotive business**. This Company had its beginnings in that business, our two founders selling tires and servicing cars.

What happened to
refocusing?

Past lack of focus has
negatively affected the
customer experience

Same Store Sales Growth Does Not Tell The Entire Story

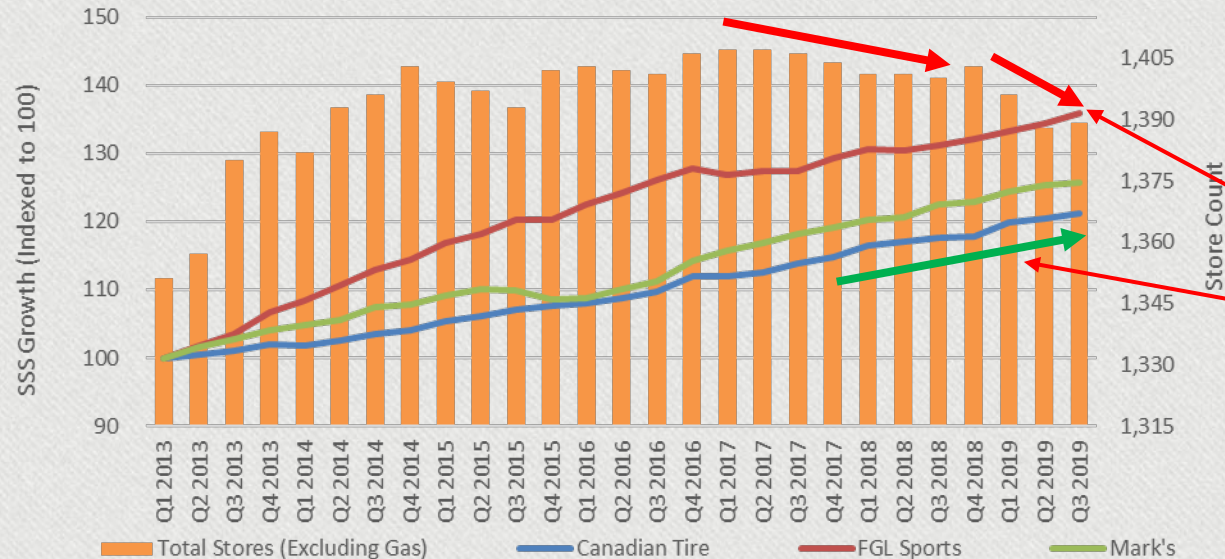
While same store sales (SSS) are growing, we believe this is not indicative of the true performance due to the declining total store count. The Company does not provide color around its store closures, the declining number of total stores, price vs. transaction detail or category mix. We believe this may be a sign that the market is over saturated. While overall store statistics are becoming more efficient, we believe this is a result of the closure of CTC's lowest producing stores and customers shifting to other locations. With the greater retail trend, we believe it is unlikely that Canadian Tire will be able to successful grow its current market share.

Over Saturated Market

[Canadian Tire Corporate Website](#)

Did you know that more than 90% of Canadians live within 15 minutes of a Canadian Tire Retail store?

Flat to declining total store count is a sign of market saturation and intensifying competition from Walmart and other competitors



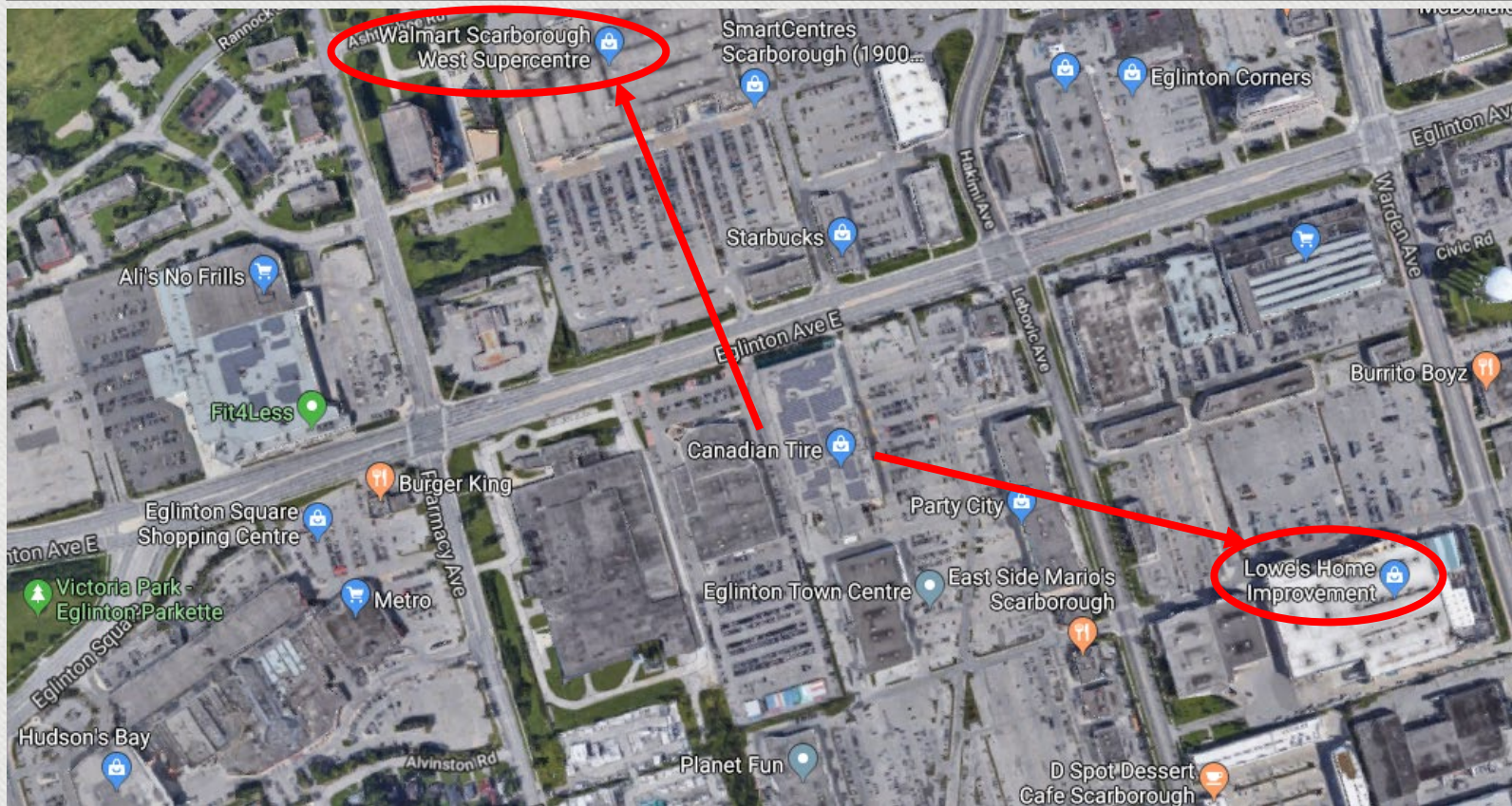
We believe the recent growth in SSS is driven by the reduction in total store count

This is a low quality way to temporally boost SSS

Fierce Competitive Landscape Due To Nearby Retail Alternatives

Canadian Tire stores are often nearby many of its major competitors. Various big box retailers (Walmart, Costco, Home Depot, Loews) have stores in close proximity to CTC banners. In more rural locations, CTC banner stores are often on the same street or in the same shopping center as Walmart. We believe this is an obvious factor for Canadian Tire's past and future retail struggles.

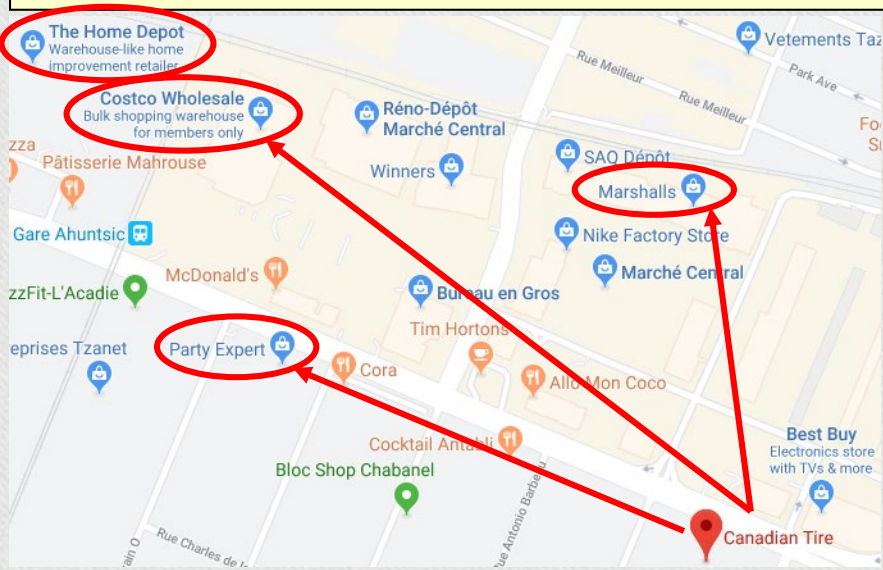
Scarborough, Ontario (Greater Toronto) – Eglinton Town Centre, 1901 Eglinton Ave E



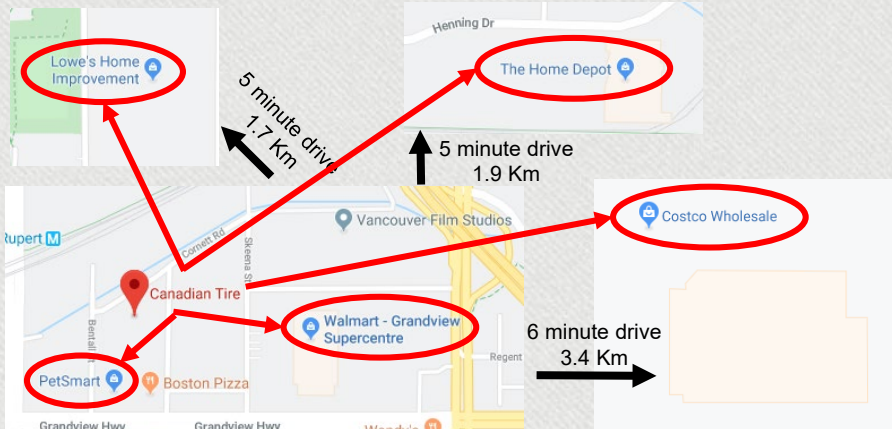


Intense Competition Across Major Cities

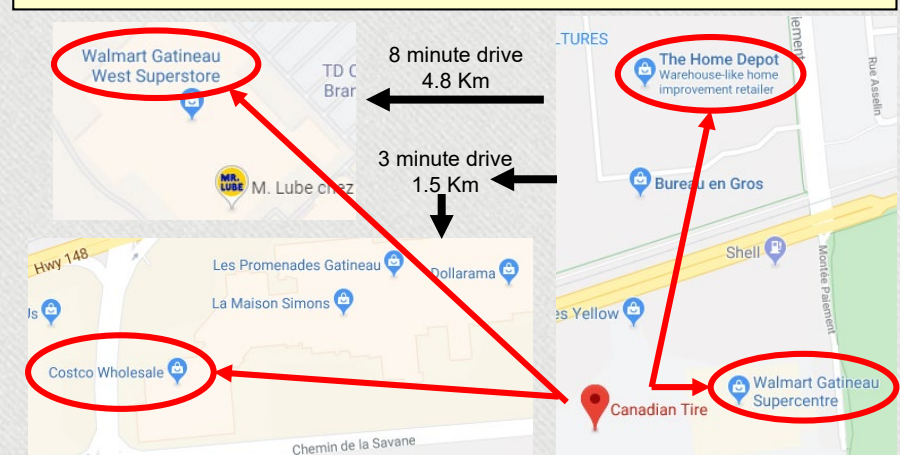
Montréal, Québec – 9050 Boulevard de l'Acadie



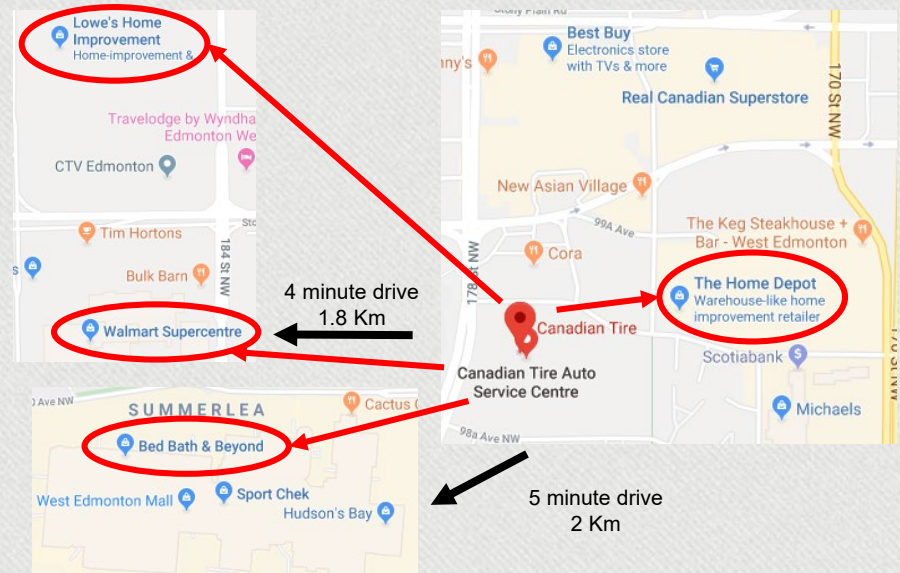
Vancouver, British Columbia – 2830 Bentall St



Gatineau, Québec (Greater Ottawa) – 700 Boulevard Maloney Ouest



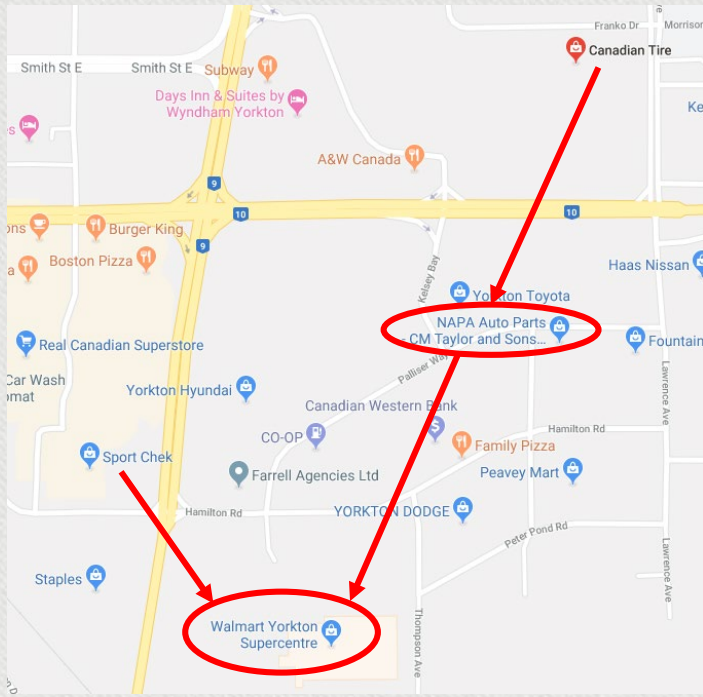
Edmonton, Alberta – 9909 178 St NW





Walmart Is Canadian Tire's Biggest Competitor In Rural Locations

Yorkton, Saskatchewan – 277 Broadway St E



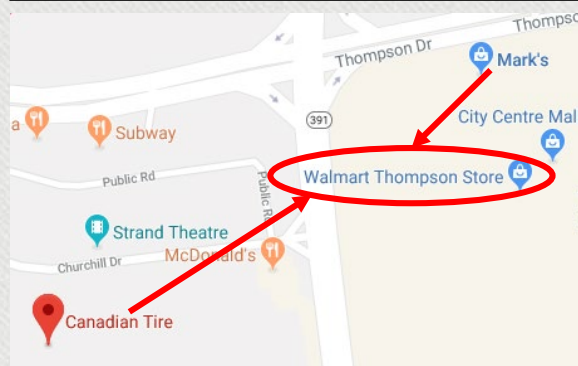
Fredericton, New Brunswick – 75 Two Nations Crossing



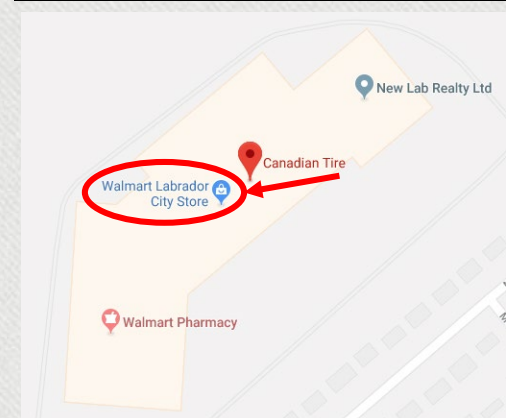
Cookville, Nova Scotia – 16 Pinegrove Road



Thompson, Manitoba – 60 Selkirk Ave



Labrador City, Newfoundland – 500 Vanier Ave



Slave Lake, Alberta – 101 Cornerstone 1500 Main Street Sw



Competition Will Become Worse As U.S. Retailers Continue Expansion In Canada

U.S. competitors plan to continue growing their presence in Canada. In the past, some U.S. retailers have had trouble due to the highly competitive Canadian market dynamics. We view the current and future level of retail competition as a major risk to CTC's business model.

Walmart

C. Douglas McMillon
President & CEO
Walmart
Q4 2018 Call
February 19, 2019

"Our business in Canada also continues to perform well. The team is moving quickly to modernize the store base and expand omni-channel capabilities with a focus on gaining greater access to urban markets. For example, we've entered into new partnerships this year in cities like Toronto and Vancouver to help expand our delivery options in grocery and general merchandise."

Judith McKenna
President & CEO of
Walmart International
Analyst Meeting
October 17, 2018

"Turning first to Canada. We've got a really strong business in Canada. It's closely aligned to the U.S., and it's going to continue to be one of our most profitable businesses with strong returns. And in addition, it continues to provide real talent for the rest of the Walmart world. The team there are innovating to modernize the store base."

Home Depot

Craig Menear
Chairman, CEO &
President
Home Depot

Q3 2018 Call
November 13, 2018

"Clearly, there are pressures in Canada from a housing standpoint. The government has made a conscious decision to slow down housing in Canada, and you see that in the numbers. But they delivered a great performance. We're seeing terrific online growth in Canada as the Canadian customer embraces e-commerce as well."

Costco

Richard A. Galanti CFO
Costco
Q4 2019 Call
October 3, 2019

"In Canada, 1 plus a year [long-term club growth potential]. We thought we were a saturated at 80 in Canada and now we have 101 or 102. **So that will keep increasing.** Certainly, there will be more -- what - I think the thing that we feel most comfortable saying is 5, 3 years from now, the penetration of the percentage of the total openings will certainly by then -- likely by then, nothing is certain, be outside of the U.S. and Canada."

Lowe's

Marvin Ellison
President & CEO
Lowe's

Q2 2019 Call
August 21, 2019

"In Canada, we posted negative comp sales for the quarter. Our negative comps was driven in large part by our ongoing RONA integration... we decided to make adjustments to the original long-term integration strategy."

Marvin Ellison
Q1 2019 Call
May 22, 2019

"In Canada, we posted negative comps for the quarter as the weaker Canadian housing market exerted pressure on the business."

Marvin Ellison
Q4 2018 Call
February 27, 2019

"We remain confident in our market position in Canada and of the long-term potential of this business."

Canadian Retail Competitive Dynamics

We believe Canadian Tire has few competitive advantages to differentiate itself in the highly competitive retail environment.



Weakness      Strength



Canadian Tire's Prices Are Not Competitive

C\$69.99 Basketball **C\$60.30**

 **CANADIAN TIRE**

amazon



Spalding Precision™ Indoor Game Basketball, Size 7

\$69.99

★★★★★ (389)

 **ADD TO CART**

Amazon's Choice



Spalding Precision Indoor Basketball, 29.5"

★★★★★ v 2

CDN\$60.30

C\$6.49 Lock **C\$5.97**


 **CANADIAN TIRE**

Walmart 



PDLOCK.DUDLEY COMB.

6.49




Dudley Combination Lock
DYRP7SP

★★★★☆ 6 Reviews

\$5.97

C\$59.99 LED Smart Bulb

 **CANADIAN TIRE**



Philips Hue A19 Colour & White LED Smart Bulb, Single

\$59.99

C\$49.99 Rice Cooker **C\$21.98**

 **CANADIAN TIRE**

Walmart 



Black & Decker 16 Cup Rice Cooker

49.99



Rice Cooker
Black & Decker 16-Cup Multi-Use


★★★★★ 6 Reviews

\$21.98
Was \$29.96

C\$29.99 Mallet **C\$17.97**

 **CANADIAN TIRE**


amazon



Estwing No-Mar Mallet

\$29.99

★★★★★ (7)



Estwing Deadhead Rubber Mallet - 18 oz No-Mar Hammer with Bounce Resistant Head & Hickory Wood Handle - DH-18N

★★★★★ v 29

\$17.97

C\$50.98



Philips Hue White and Colour Ambiance A19 60W Equivalent Dimmable LED Smart Bulb - ...

★★★★★ (91)

\$50.98 / each

No Free Online Shipping!

Canadian Tire's shipping fees are the worst among its competitors as CTC is the only peer not to offer free shipping. We believe it will be very hard to be competitive in e-commerce with high shipping costs. If Canadian Tire ends up offering free shipping, it will have to find other cost measures to offset further margin decline.



Get affordable shipping rates, starting at \$4.99

No Free Shipping



TWO-DAY SHIPPING

Fast, free delivery on millions of items

Super-fast shipping, millions of items, and flexible delivery options to fit your life.



2 business day delivery when ordered by 12pm
No separate delivery surcharge with orders of \$75 or more



FREE

on orders above \$50 before taxes



FREE SHIP TO YOU



FREE shipping over \$75
and \$8.99 flat-rate shipping
for orders under \$75



FREE PARCEL SHIPPING OVER \$49*

Free Shipping Will Further Pressure Margins

**Q3 2019
Call**

"And we've also been testing free shipping at SportChek from Triangle Mastercard members."

Implementing free shipping will be detrimental to CTC's already declining profit margins

Competition In Canadian Gas Market Will Lead To Further Margin Erosion

We believe the largest threat to Canadian Tires' Petroleum business is competition from Costco and the increased pressure on pricing will erode CTC's current profitability. Costco's prices are extremely competitive and multiple sources show its gas is up to ~10c cheaper per liter (~9% below Canada's market price). If CTC needs to lower its prices to compete with Costco, it could have a detrimental effect on CTC Petroleum's profitability.

2019 Second Third Quarter Earnings Presentation (slide 7)

- Lower net per litre fuel margin at Petroleum reflecting a more competitive marketplace and the impact of the newly implemented carbon tax in some regions, lower growth in profit from the Company's margin-sharing arrangement with its Dealers, the impact of IFRS 16, and higher interest expense.

Recent Pressure On CTC's Petroleum Gross Margin

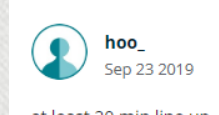
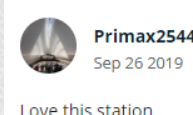
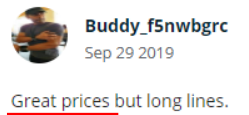
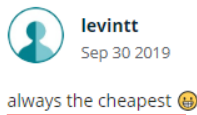


Risk To Profitability

C\$/L	
Canada Average Gas Price	\$1.15
Costco Gas Price	\$1.05
Costco Discount	\$0.10
CTC LTM Petroleum Gross Margin	9.0%
Gross Margin Lost @ C\$1.05/L	8.7%
CTC Lost Profit	~\$165

Represents potential ~15% hit to CTC's EBT

According To Gassbuddy.com, Costco Gas Are The Best Priced Gas Stations And Are Very Popular



Out Of Date IT Infrastructure

Based on Glassdoor.com reviews, it appears CTC is lagging peers in the quality of the technology and IT infrastructure. For a Canadian wide retail player, CTC is not well positioned to capture the changing retail environment with the rising threat of Amazon and other major e-commerce players. We believe it will be difficult for CTC to catch up to its e-commerce competitors given CTC's lack investment in improving customers' online experience.

Employee Reviews Towards IT Are Negative

"It's a retail company who thinks it's competing with Amazon without any technology"

Pros: if you don't want to work and still wants to get paid, this is the company

Cons: This is a company which **knows nothing about technology**. It's just a retain company which has small IT division which supports few requests from business. However top management, and lower management also thinks that they are competing with Amazon and says that very proudly in company All Hands meeting. I haven't seen so incompetent engineers that I have seen here, And solution architects and Managers are worst. Solution Architect are nothing but Business Analyst who just understands the requirement from business and draws a vision regarding how data should flow. Managers doesn't even know what managers are supposed to do. **No one understands the Agile here**, however they still have scrum masters which is a joke.

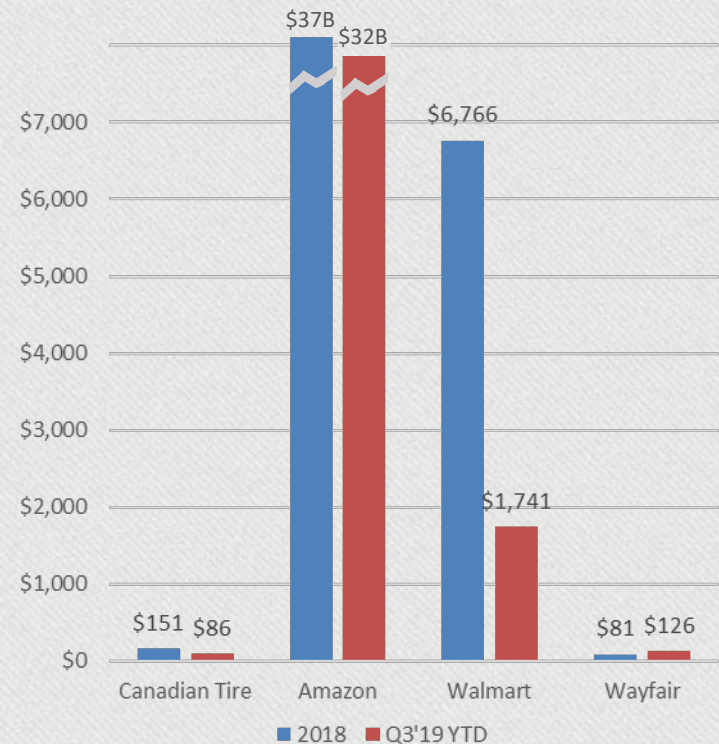
Advice to Management: **You can not compete with Amazon, every Software Engineer in your organization knows what, so stop saying that in all hands and stop looking fool. However, Hire technical managers from those company if you want to improve.**

"If you're an IT professional avoid this place like the plague!!! Especially Finance IT!"

Cons: Horrible leadership. Lazy long-term employees. Toxic work environment. **Especially in Finance IT. Business hates IT and vice versa.** Worst place I've ever worked. Thank goodness I found another job quickly and got out after just a short time. I won't ever shop at Canadian Tire again after this experience.

Advice to Management: Clean house and get rid of incompetent leadership! Don't call yourself an Agile shop because you ARE NOT! Send your managers and staff on training to learn how to treat others with respect. If you want to attract and keep skilled resources create a positive and supportive environment and get rid of time wasting processes (like the ridiculous ones PMO keeps introducing).

IT Spending Relative To Competitors



How can CTC compete against major competitors in e-commerce with its insufficient IT spend?

Note: All figures in millions of Canadian Dollars, conversion based on average exchange rate over period. WMT based on Q2'19 YTD

Source: [Glassdoor.com](https://www.glassdoor.com), Company filings

Online Popularity Data Signals Weakness

Google Trends data suggests Canadian Tire's popularity is relatively flat while Amazon continues to gain popularity in Canada. Additionally, the data suggests Canadian Tire is less popular than during prior years' November peaks. We believe this is a reflection of the increasing retail competition in Canada.

Google Trends Canada Search For "Canadian Tire"



According to Google, interest in "Canadian Tire" is below typical November highs

Google Trends Canada Search For "Amazon.com"



Canadian Tire's popularity is flat while Amazon's is rising

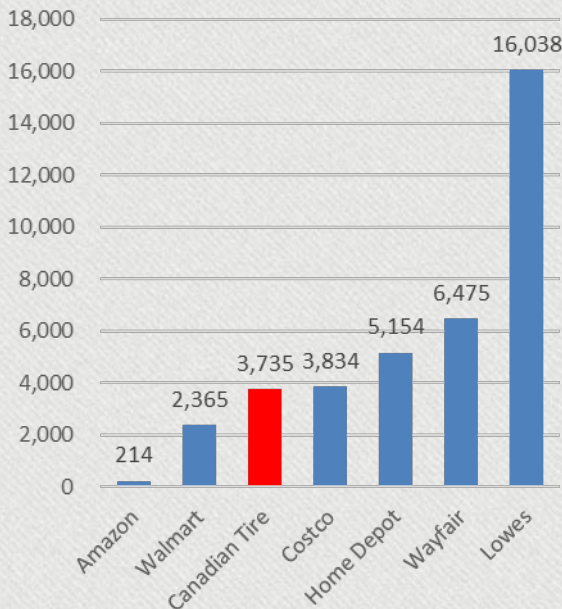
Website Engagement Is Lagging Peers

Website traffic data suggests a difficult path forward for Canadian Tire. Visitors of Canadian Tire's site are 25x more likely to visit amazon.ca than another consumer. This compares to 1.5x as likely for U.S. Walmart customers to visit Amazon.com. While Canadian Tire ranks 3rd in user traffic, its worst in class pageviews per user and time spend on site signals poor customer engagement.

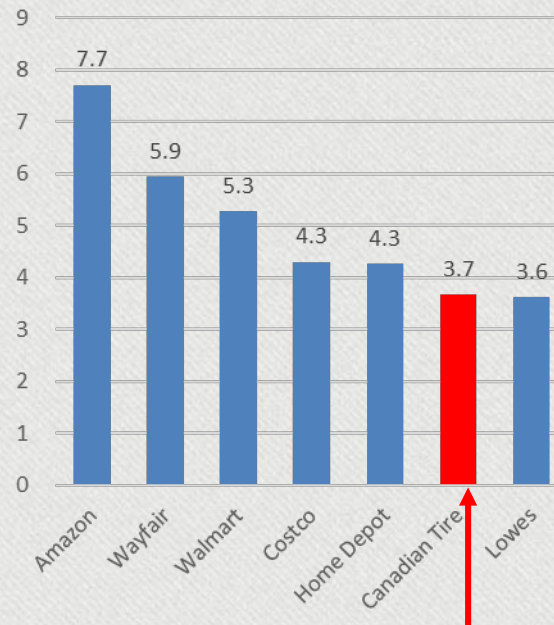


Visitors of Canadian Tire's site are 25x more likely to visit Amazon

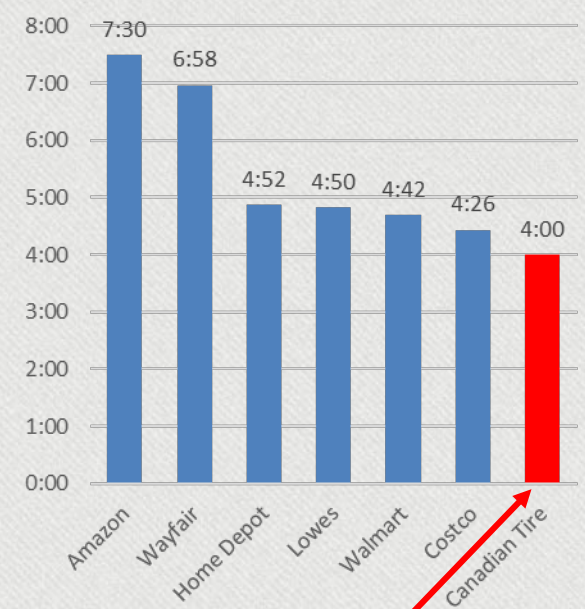
Alexa Traffic Rank



Pageviews Per User



Time On Site (in minutes)



User data suggests CTC's engagement is among the worst relative to peers

Mobile App Data Trends Are Worse

Mobile app data shows Canadian Tire is in a much worse position than the market believes. Management stated its app now has over 500k monthly visits, but data shows the number of monthly users and average time per user is flat. The most telling statistic of Canadian Tire's struggles is cross-user penetration by Amazon. Over the past 2 years, the percentage of CTC app users who also use the Amazon app has increased from 50% to 75%.

Allan MacDonald
EVP, Retail

Q3 2019 Call – November 7, 2019

*"In Q3, we re-launched our CTR mobile app with enhanced search and functionality for our automotive customers. And now we have **over 500,000 monthly visits.**"*

Our Research And Mobile App Data Shows A Much More Threatening Story Than Management Claims

Spruce Point Research

Active users and average time per user are flat
During this time period Amazon's active users are up over 60%

Downloads are down from 2 years ago

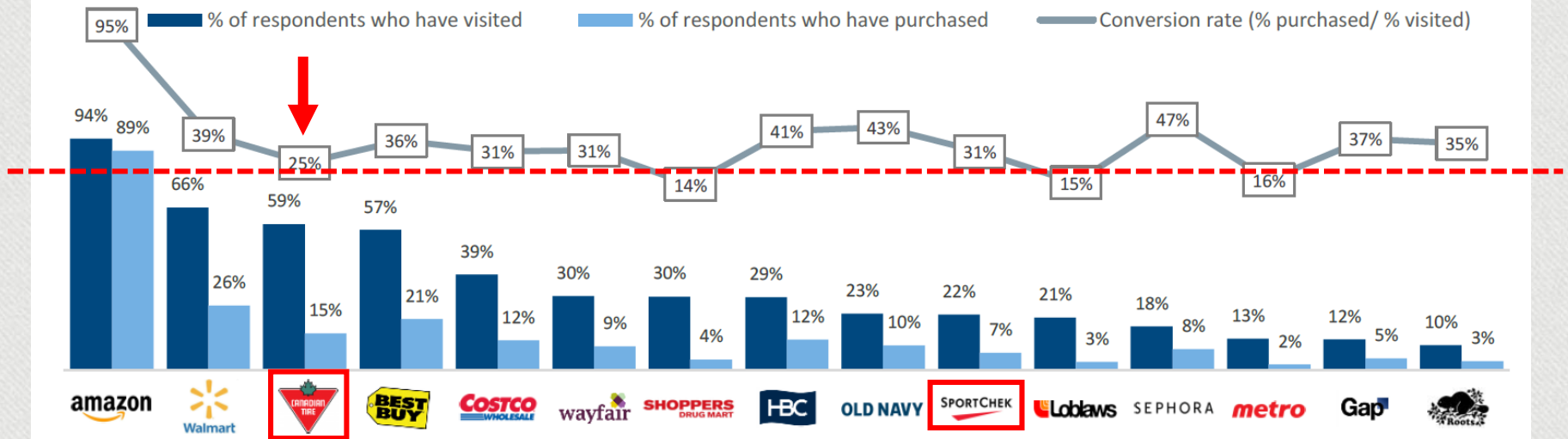
Over the past 2 years, the percentage of Canadian Tire App users who use the Amazon app has increased from 50% to over 75%

Amazon's Canadian "Showroom"

Canadian Tire has one of the lowest conversion rates (% customers who purchase / % who visit the store) based on RBC Capital Markets research. We believe this is indicative of CTC's continued retail struggles as e-commerce continues to gain share in Canada.

Exhibit 3: Amazon continues to dominate the landscape; 89% of 2019 respondents made a purchase in the past year

Have you visited/made a purchase at the following retailers within the past year?
Top-15 responses provided below



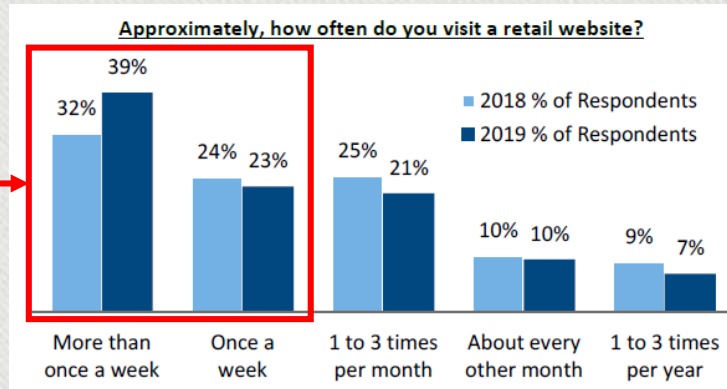
Note: The survey question included the following companies/websites: Amazon, Walmart, Best Buy, Canadian Tire, Costco, The Bay, Loblaws, Metro, Nordstrom, Old Navy, Roots, Saks Fifth Avenue, Sephora, Shoppers Drug Mart, SportChek, Gap, Aritzia, and Wayfair
 Source: RBC Capital Markets, Proprietary survey of 1,206 respondents (2019) via Survey Monkey

Low conversion rate shows that website and mobile app user data does not mean Canadian Tire is able to sell to those users

E-Commerce Trends Are Negative For CTC

As customers continue to focus on the lowest price and shift towards online shopping, Canadian Tire will be at a disadvantage to its competitors who offer competitive pricing, free shipping and a better online experience.

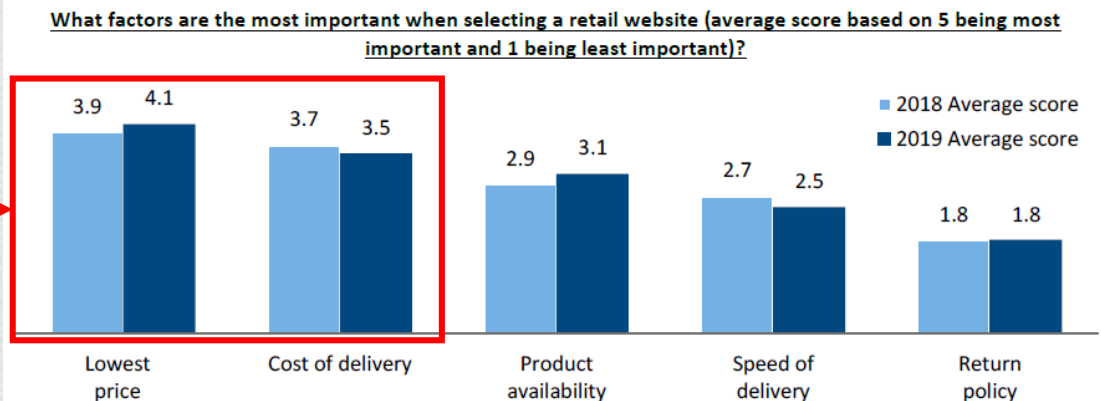
62% of respondents visit retail websites at least once a week



Customers are price sensitive

Lowest price is the primary determinant of where customers shop. Shipping cost is second

Exhibit 4: Price/cost and availability are most important to where consumers shop online



Source: RBC Capital Markets, Proprietary survey of 1,206 (2019) and 1,011 (2018) respondents via Survey Monkey

Canadian Tire: Your Grandparents' Retailer

Based on our research, we believe Canadian Tire is not capturing the next generation of consumers due to its lagging e-commerce, social media presence and allure to millennials. Management is aware of this problem but does not appear to have an effective solution. Price and convenience of delivery, two areas CTC lags its peers, are key factors in millennials purchasing choices.

Allan MacDonald
EVP, Retail
Q2 2019 Call - August 8, 2019

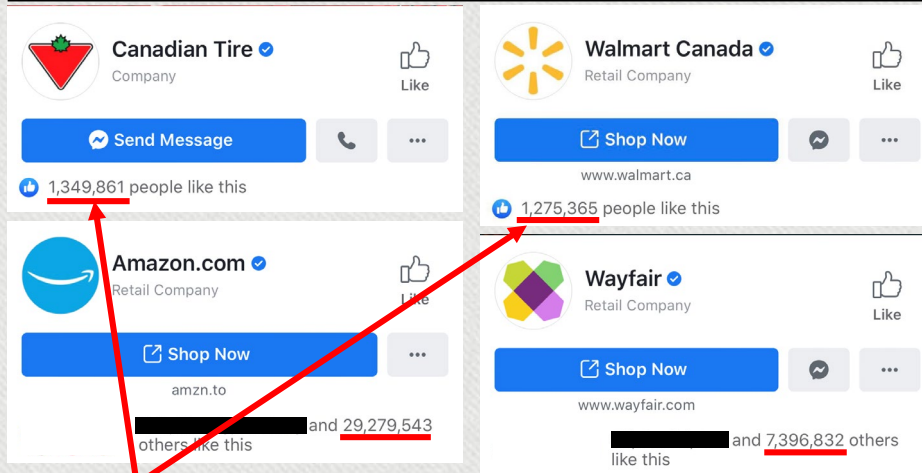
"So Party City is going to make Triangle Rewards more attractive **to customer segments that are frankly very interesting to us like young families, millennials**. And Party City is going to benefit hugely."

Spruce Point View

While the Company acknowledges it must focus on gaining younger customers, we believe CTC is lagging its peers at attracting millennials. Overpaying for acquisitions will not solve the problem

Canadian Tire's Social Media Following Is Lagging Its Peers

Facebook



Walmart Canada's pages alone are on par with or better than Canadian Tire's

Instagram



Power of E-Commerce

Wayfair Canada launched in 2016, yet its Instagram following has surpassed Canadian Tire

Wayfair: More Competition Is Coming

Wayfair is a prime example of the growing e-commerce threat to Canadian Tire's brick-and-mortar business. We believe this risk is being overlooked by the market as sell-side analysts have not mentioned Wayfair in their research. Wayfair, like many online specialty retailers, offers consumers competitive prices, free shipping and a wider range of products. While e-commerce in Canada lags the U.S., Canadian consumers are catching up.



Amazing Value Every Day

Items you love at prices that fit your budget.



Fast & Free Shipping Over \$75*

Plus, two-day delivery on thousands of items.



Expert Customer Service

Our friendly team's on hand seven days a week.



Unbeatable Selection

All things home, all in one place.

Wayfair Has Experienced Strong Growth Since Moving Into Canada

Canaccord Genuity Growth Conference (August 7, 2019)

Maria Rippes
Canaccord
Genuity

"What kind of milestones do you have in mind for building out Wayfair's brand?"

Niraj Shah
Co-Chair, Co-
Founder &
CEO Wayfair

"Yes. So we think there's an opportunity to be a -- for Wayfair to be a mass consumer brand with household awareness at each country we're in. So at the United States, we're basically at that level. We've been at that level now for a little while. **In Canada, we're basically at that level more recently.**"

Wayfair Q2 2019 Earnings Call (August 1, 2019)

Niraj Shah

"In Canada, we're seeing sequential acceleration in growth."

Wayfair Q3 2019 Earnings Call (October 31, 2019)

Niraj Shah

"In Canada, though the majority of goods we sell cross the U.S. border, **the team is focused on achieving market pricing and lower cost** by driving higher CastleGate penetration in Mississauga and leveraging our Asian consolidation operations to ship more product directly from Asia to Canada via full mix containers."

Goldman Sachs Global Retailing Conference (September 4, 2019)

Steve Conine
Co-Chair &
Co-Founder
Wayfair

"And then Canada, I think we have a leadership position in the home market. We grew very quickly in Canada. I think **we were able to offer selection to the Canadian customer the way they hadn't ever seen before**. We, then, I think have gone through a period where we've had to figure out how do we provide value as well as selection to the Canadian customer, so we've opened up a big warehouse in Mississauga, Canada, which we're just starting to bring containers into. That's letting us unlock then really providing very good value on top sellers and popular products in Canada, which **I think will let us continue to really grow that market aggressively.**"

Niraj Shah
Co-Chair, Co-
Founder &
CEO Wayfair

"One for example is when we expanded into Canada from the U.S., all the infrastructure we built for the U.S. was very pertinent for Canada. As a result, we were -- very quickly, we were able to become a leader in Canada."

Acquisition of Helly Hansen

Canadian Tire announced its acquisition of Helly Hansen (HH) in May 2018. HH had a history of private equity ownership. We believe CTC significantly overpaid for the business.

A History Of Private Equity Ownership

Year	Sponsor	PE?
1997	Investcorp	✓
2006	Altor Equity Partners	✓
2012	Ontario Teachers' Pension Plan (75% stake)	✓
2015	Ontario Teachers' (remaining 25% stake)	✓
2018	Canadian Tire	

[Financial Times Article \(June 16, 2016\)](#)

Helly Hansen enjoys turnaround after back-to-basics push

Ontario Teachers' Pension Plan overhauls Scandinavian brand after cash-flow problem

Financial Times
(FT)

"Under the turnaround Helly Hansen overhauled its management and cut its product lines by a quarter. Working capital fell to a third from more than a half of its sales as it reduced inventories and cut capital spending."

Paul Stoneham
CEO
Helly Hansen
FT Quotes

"We focused on the basics of getting cash in as quickly as we could... Quite frankly the first three to four months weren't particularly pleasant... We've taken the business from being a sales-driven company in the last 10 years to a more consumer-focused one"

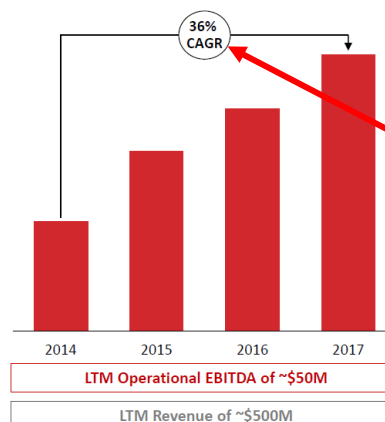
Spruce Point
View

Spruce Point believes prior private equity owners maxed out Helly Hansen's growth potential and HH's most recent sponsor dressed the business well for the sale process. CTC paid an astronomical valuation for a risky acquisition and a business that has since underperformed.

Helly Hansen Was Marketed For A Sale

[Helly Hansen Acquisition Investor Presentation \(May 2018, slide 11\)](#)

Historical Operational EBITDA



EBITDA growth significantly outpaced revenue growth leading up to the acquisition. We believe this is a clear sign of increased efficiencies by Ontario Teachers' to make Helly Hansen more attractive for a sale. Our view is supported by HH's lackluster performance since the acquisition

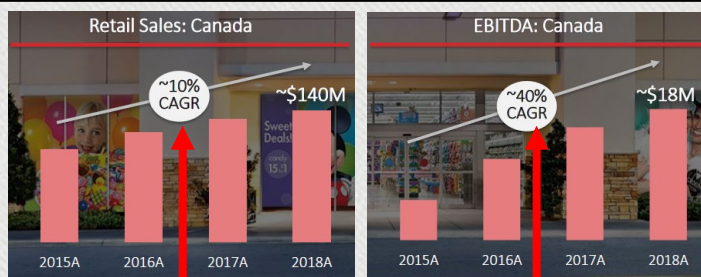
Generated a 3 year Operational EBITDA CAGR of 36% and a Revenue CAGR of 12%

In our opinion, the implied EBITDA multiple of ~20x (based on the purchase price of C\$985m and LTM EBITDA ~C\$50m) is evidence Canadian Tire over paid for a lousy asset

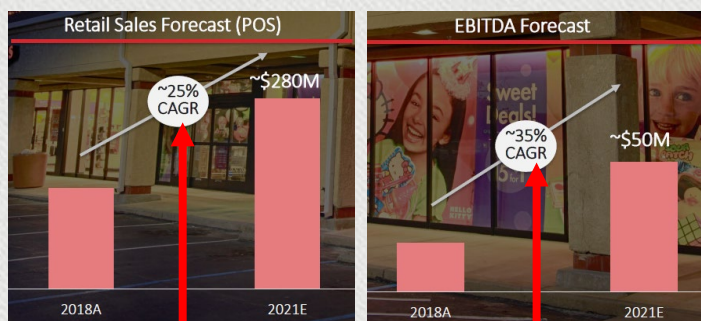
Round 2: Acquisition of Party City Canada

We believe there are many similarities between CTC's acquisition of Party City's Canadian business and its failed acquisition of Helly Hansen. In our opinion, CTC overpaid for Party City Canada based on overly optimistic 3-year financial assumptions of doubling sales and 75%+ EBITDA growth.

Party City Canada Acquisition Investor Presentation (August 2019, slides 3,8)





Party City's recent revenue and EBITDA growth looks very similar to Helly Hansen's performance leading up to the acquisition. Is it a coincidence that Party City has been private equity owned and Thomas H. Lee Partners remains its largest shareholder?



We believe Party City Canada's financial forecast is overly optimistic and reminds us of the optimism before the Helly Hansen acquisition. We find it very hard to believe the projected 25% revenue CAGR given customers accessibility to purchasing party goods online and the overall weakening retail sector

Optimistic Acquisitions Typically Lead To Lackluster Results...

		
History of Private Equity Ownership	✓	✓
Brand Recognition	✓	✓
Strong Historic Revenue Growth	✓	✓
Strong Historic EBITDA Growth	✓	✓
High Expectations by Management	✓	✓
Expected Synergies from CTC Retail Presence	✓	✓
Implied EBITDA Multiple	~20x	~10x
Spruce Point Long-Term View	↓	↓
Performance Post-Acquisition	↓	?

Why wouldn't Party City Canada face the same pressure from e-commerce as Party City has in the United States?

The pressure on Party City's U.S. business has resulted in the closure of 45 stores in 2019

Party City: Canada Different Vs. The U.S.?

Party City is a struggling retail business facing an abundance of competition from other retailers and online competitors. We believe Party City Canada's fate will follow Party City's in the United States. Party City Canada is not the type of business a company should borrow to purchase on top of an already over-levered balance sheet. PRTY shares are down 70% since releasing earnings on November 7th, 2019.

Forbes Article (November 7, 2019)

Party City Blames Helium Shortage And Halloween Miss As It Loses Two-Thirds Of Value, But Issues Go Way Deeper

Party City has become its own party pooper: the stock slumped 67% on Thursday to its all-time low of \$2 a share after the largest U.S. specialty party-supplies chain posted an unexpected third-quarter loss and cut its annual outlook.

"Many of the expected tailwinds didn't materialize," CEO James Harrison said on a conference call Thursday, adding that Party City wasn't alone. He pointed to the National Retail Federation's forecast that Halloween spending this year was expected to decline to \$8.8 billion, from \$9 billion last year.

Boston 25 News Article (October 23, 2019)

Proposed bill targets potential ban of helium balloons in Mass.

Since any other purchase can be made online, Party City's brick and mortar business is dependent on helium balloon sales

CTC acquired Party City at the worst time with the headwinds of the helium shortage pressuring balloon sales

Canadian Tire just purchased the Canadian assets of a company who's U.S. business lost 67% of its value in one day

Canadian Tire has provided optimistic financial forecasts for Party City Canada while Party City is cutting its outlook in the U.S.

It is not surprising that many of the expected tailwinds were over hyped and the Company ended up failing to deliver

We believe Party City Canada will end in a similar unsuccessful fashion as Party City and Helly Hansen

Recent legislation in some U.S. states, including Massachusetts and New York, have targeted helium balloons due to their negative environmental impact. We believe this only presents further challenges to Party City's business and could lead to future legislation in Canada



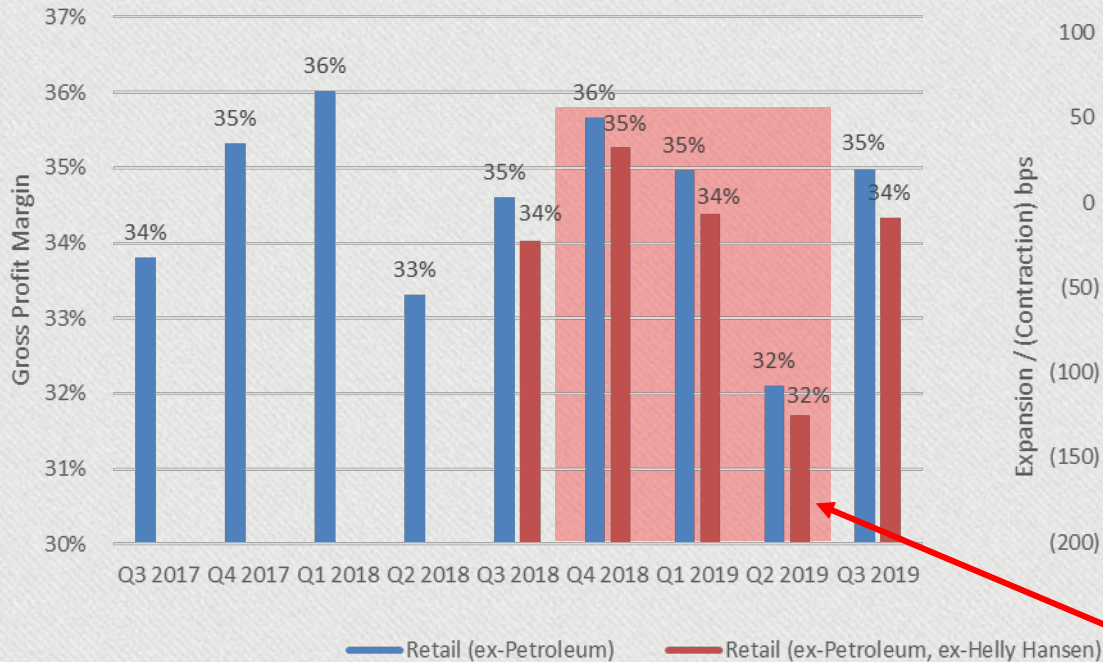
Organically Declining Business



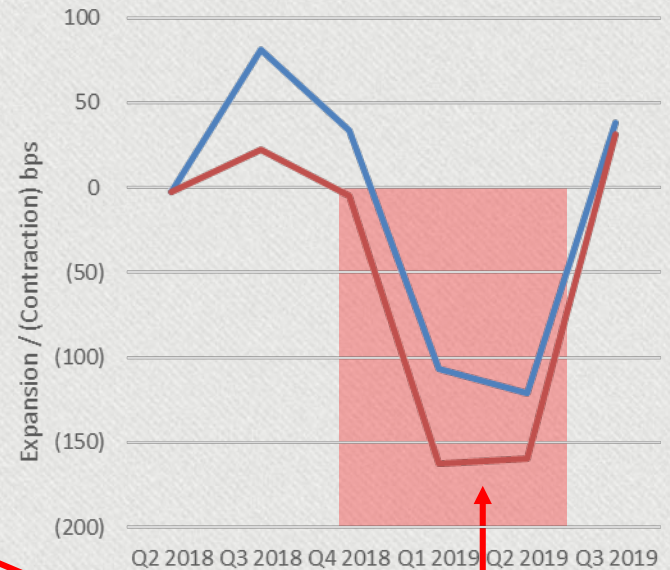
Underlying Retail Business Is Struggling

Since the acquisition of Helly Hansen, we have reason to believe CTC's legacy retail business is struggling. CTC's retail business (ex-Petroleum and ex-HH) is experiencing weaker revenue growth and persistent gross profit margin compression. This should be worrisome as CTC's poor retail performance is at a time when the Canadian economy is at historically low levels of unemployment and experiencing an expanding consumer credit market. We believe the market is overlooking this weakness and may be caught off guard, due to the inclusion of Helly Hansen, which is not explicitly broken out on a gross margin basis. In a historically strong Q3'19 retail margins are in-line with Q3'18.

Reported Gross Margin vs Ex-Helly Hansen



Gross Margin Change Y-o-Y



Multiple quarters of Y-o-Y margin contraction

Sell-Side Did Not Address The Effect Of Helly Hansen On Gross Margin

It does not seem that the sell-side considered the positive effect Helly Hansen had on retail gross margin. While disappointed in CTC's gross profit margin contraction of 120bps, it does not appear any consideration was given to the fact that without the acquisition of Helly Hansen, CTC's margin would have been significantly worse.

Sell-side Response After Disappointing Q2 2018 Earnings

Patricia Baker
Scotiabank
August 8, 2018

*"Underlying operating performance at Retail was down y/y. CTC did drive positive SSS across banners in Q2. EBITDA (est. ex-IFRS 16) of \$400.6M rose 1.7% y/y reflecting 13.1% growth in CTFS, while Retail EBITDA fell y/y to \$230M on lower Retail GM. **Retail GM declined 120 bp**, with CTR down 100bp, reflecting a lower true-up benefit related to margin sharing and negative shipment mix. Consolidated revenue rose 5.9% (5.4% ex-fuel) reflecting HH, strong receivables growth and the 3.3% uplift in retail sales. Retail SG&A rose 10.7% primarily due to inclusion of HH."*

Mark Petrie
CIBC
August 8, 2018

*"The focal point of the Q2 results was weak Retail EBITDA. Excluding one-time costs and a tax benefit, \$398MM was short of our \$430 MM estimate, however this figure still includes \$29MM of other non-recurring gains. SG&A was well-controlled, but **GM% was down 120 bps, primarily at CTR**. -50 bps was driven by a negative swing in dealer profit sharing and another ~50 bps from poor sales mix (less high-margin seasonal goods given unfavorable weather). All this to say - the quarter was weak but does not lead us to believe the Retail business is weakening. And if an increased focus on opex efficiency can deliver comparable gains to the past GM% focus (notwithstanding recent noise), re-accelerated earnings growth is within reach."*

Acquisition Of Helly Hansen Is Failing To Deliver On Expectations

Helly Hansen (HH) is underperforming since the acquisition. Based on CTC's filings, HH's revenue growth for the first half of 2019 has been flat year-over-year. Despite strong reported growth for the third quarter, we believe this is a result of selling inventory to CTC owned stores due to the strong correlation of HH Canada Revenue and CTC's Intersegment Revenue.

2019 First Half Growth

H1 2018	\$239.3
H1 2019	\$239.4
Y-o-Y Growth	0.04%

YTD Q3'19 Growth

YTD Q3 2018	\$421.0
YTD Q3 2019	\$451.1
Y-o-Y Growth	7.15%

Strong reported sales made Helly Hansen growth appear stronger than it really is

C\$ mm	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019
Helly Hansen Revenue	--	--	\$182	\$166	\$141	\$99	\$212
HH Foreign Revenue	--	--	\$157	\$139	\$123	\$83	\$146
HH Canada Revenue	--	--	\$25	\$27	\$18	\$15	\$66
Other & Intersegment Revenue	\$2	\$4	(\$1)	(\$14)	(\$8)	(\$8)	(\$44)

The strong correlation and recent spike of both Helly Hansen Canada Revenue and CTC's Intersegment Revenue suggests Canadian Tire is pushing inventory to CTC retail stores in order to show strong growth in its struggling Helly Hansen brand

While bulls may argue this is due to the upcoming winter season, we believe management has used this aggressive practice to show strong growth in their prized acquisition

Helly Hansen Inventory Is Sitting In Canadian Tire Banner Retail Stores

Allan MacDonald
EVP, Retail
Q3 2019 Call
November 7, 2019

"Helly Hansen's Canadian business grew at a remarkable 60% versus last year. Now this was our plan all along. Capitalizing on opportunities at SportChek and Mark's, as they built their inventory positions for key following winter seasons and introduce fantastic new displays and merchandise."

Canada Goose: Helly Hansen Competitor Expects A Weak Winter Ahead

Canada Goose warned investors of a weak quarter ahead due to sales being pulled forward into the past quarter. This sounds very similar to Helly Hansen's strong Q3. However, while Canada Goose warned that the pull forward will result in a weaker quarter ahead, Canadian Tire continued to talk up the strength of its recently acquired brand.

Reuters Article (November 13, 2019)

Canada Goose sees frosty winter on earlier-than-usual shipments

Shares of Canada Goose fell 10% on Wednesday, erasing premarket gains, after the company said third-quarter revenue from wholesale, its biggest business by sales, would decrease in the mid-teens on a percentage basis from a year earlier.

Canada Goose shares fell 10% after management told investors next quarter will be weaker than expected due to earlier shipments that benefited this past quarters results

Dani Reiss – Canada Goose CEO
Q2 2020 Call – November 14, 2019

"We've shipped so much of our fall/winter order book earlier, which naturally means less shipments in the next quarter."

Similar to Helly Hansen, Canada Goose experienced strong sales over the past 3 months as inventory was filled at retail stores. We believe, this will result in weaker sales next quarter



Canadian Tire's management continues to talk about the strength of Helly Hansen's business. Why didn't CTC provide investors with a similar warning?

Helly Hansen CEO Warned Of Acquisition Risk

Helly Hansen's CEO Paul Stoneham warned that Canadian Tire's acquisition of Helly Hansen may have a negative effect on Helly Hansen's relationships with other retailers. As Helly Hansen's current growth is in Canada and it is losing share in other markets, we believe the bulk of the growth has been coming from Canadian Tire stores. This weak performance should be a big shock given management's high expectations leading up to the acquisition. In CTC's 2018 first quarter earnings call, management stated that over the past 12 months, HH's EBITDA grew at an impressive rate of 36% and has significant upside. Since the acquisition, HH's sales in Canadian Tire stores are up as they have been pushing HH and offering the full assortment across all CTC banners. Given flat overall revenue growth, HH must be experiencing declining sales and losing market share outside of CTC stores.

Management Has Been Overly Optimistic

Allan MacDonald
EVP, Retail
[Q2 2019 Call](#)
August 8, 2019

"Probably the best example of this playbook in action is Helly Hansen in Canada, our biggest project to date. So far, we're on track with our plans for bringing Helly Hansen to life across Canada, with expanded assortments online and in stores, and it's working. Helly Hansen sales in Canada year-to-date June were \$39 million, up 63 percent in Q2 alone. I'm very proud of the partnership with the Helly Hansen team, and together we've strengthened the Canadian Tire marketplace. I'm looking forward to more opportunities like this in the future."

HH CEO Paul Stoneham Warned of Risk

SGB Media
[Article](#)
May 29, 2018

Stoneham said the acquisition could affect some of Helly Hansen's relationships with retail or e-tail competitors of Canadian Tire, but that the company is focused on honing a channel strategy under the new ownership. He also said reaction from retail partners was "across the range," and he expects things to work out as the integration kicks in and the brand gets a financial and marketing boost from Canadian Tire.

Despite Poor Performance, Management Says Everything Is Going As Planned

HH's struggling performance may come as a surprise to analysts and investors as management has insisted across calls that the acquisition is going as planned. In our opinion, management remains overly optimistic as HH has been losing market share and has made up for this decline by pushing sales in its own stores. Management has only mentioned growth through its own channels and has not touched on any positives or growth outside of CTC banners. Management may believe that this trend will reverse but it seems highly probable that HH CEO's worry of the acquisition affecting other retail relationships is coming true.

Dean McCann
CFO
Q2 2019 Call
August 8, 2019

"To explain our performance in the quarter, I've broken out the impacts into two categories. First, factors that impacted us positively, and second, factors that didn't go our way in the quarter."

"Third, Helly Hansen's earnings **performed as expected** in Q2 and year-to-date."

"The future is also about having the courage to take some risk, prudently managed risk but risk nonetheless. Our Helly Hansen acquisition is a good example. **It's now our fastest-growing asset.** And neither the Board nor our management doubted that for a moment."

"It's also been a year since we announced our acquisition of Helly Hansen and Musto. The executive team has managed the transition very well. And today, performance is exceeding our expectations. Helly Hansen has provided our Canadian Consumer Brands team with an international view to brand development. And here in Canada, the Helly Hansen and Canadian retail and marketing teams have executed an impressive campaign with new marketing, merchandising and assortments **that will take Helly Hansen sales in Canada from \$75 million in 2018 to \$130 million this year.** Along with our international growth, **we are well on our way to creating our first billion-dollar brand.**"

Stephen Wetmore
CEO
Q1 2019 Call
August 8, 2019

"But in reference to Helly Hansen, our integration efforts and their **financial performance are both proceeding on plan.** Two thousand and nineteen retail sales performance in Canada **is expected to almost double** to \$130 million and their international performance is also on track."

Stephen Wetmore
CEO
Q4 2018 Call
February 14, 2019

"When we acquired Helly Hansen, the projections that we used at that time for ourselves had an overlay from their executive management team saying they believe that they can perhaps hit stretch targets. We didn't look at it that way, but **they in fact did hit their stretch targets,** so congratulations to all of them, extremely well done. We have during the course of this year **increased our sales of their products in our stores** but it's very, very early days, so the curation of that assortment is what Allan and his team have done with the Helly Hansen executive team, so they're setting up—that was my reference in my comments of the **30 percent growth for 2019,** will relate to them getting those assortments in store at the right times, etc. based on how Allan and team want it through our various banners. So yes, we're pleased right across the board with the execution of Helly."

Performance Below Expectations

Canadian Tire has been unsuccessful in meeting its own guidance. CTC reports its on track for two out of three of the targets but we believe this is optimistic.

Optimistic 3-Year Targets

2018 Annual Report (page 13)

Financial Measure	2018 Performance	Achieved/ on-Track in 2018
Consolidated Comparable Sales Growth (excluding Petroleum) of +3 percent annually	2.2%	<u>Not achieved</u>
Average Annual Diluted EPS ¹ Growth of 10+ percent over the three-year period	12.0%	On Track
Retail ROIC ² of 10+ percent by 2020	9.2%	On Track

¹ Based on normalized results

² Retail ROIC is calculated on a rolling 12-month basis based on normalized earnings. Refer to section 11.3.1 in this MD&A for additional information.

The Company did not achieve its aspiration for +3 percent sales growth in 2018 due in part to the unseasonable weather in April and December. The Company remains committed to +3 percent consolidated comparable sales growth on an annual basis. The Company is on track to meeting its EPS and ROIC financial aspirations for three years ending 2020. Refer to section 7.0 Financial Performance of this MD&A for details on Company's financial performance in 2018.

Did not achieve SSS growth expectations

EPS growth achieved due to recent one time benefits to growth

Despite original guidance stating "no major changes to the Company's financial leverage and capital allocation approach," CTC has since repurchased shares and increased debt

Management continuously blames poor performance and missed targets on "weather"

When will management accept accountability?

CTC reports being "On Track" for its ROIC goal of 10% despite reporting ROIC of 9.2% in 2018

We believe achieving 10%+ ROIC is overly optimistic given Retail's declining margins and increasing competition. 2019 Q1 and Q2 ROIC were reported as 8.9% and 9.2%, respectively

Q3 2017 Earnings Call Presentation (slide 10)

No major changes to the Company's financial leverage and capital allocation approach

Cost Savings Initiative Is Not Clear

We believe Canadian Tire's cost savings plan is too little and too late. As shares rose 6.5% over the next two trading days, the market has fully bought in to management's plan, despite most retail restructurings ending in failure. Iain Kennedy, CTC's executive leading the initiative, has failed twice before while at BlackBerry and Celestica. After purchasing Helly Hansen and Party City, we believe it will be difficult to execute such an aggressive cost savings plan.

Canadian Tire Press Release (November 7, 2019)

- Operational Efficiency program announced to target \$200+ million in annualized savings by 2022

Focus areas include:

- Eliminating duplicate systems and processes across our multiple banners as we begin operating as One Company
- Driving enterprise-wide efficiencies by decommissioning legacy infrastructure
- Continuing our extensive program targeting internal and external expense reduction

We are skeptical of CTC's broad cost savings plan as management failed to articulate many specifics

Q3 2019 Earnings Call (November 7, 2019)

Allan MacDonald
EVP, Retail

"In terms of growth, I would say, growth is reflective of engagement. We don't have a strategy necessarily to grow the e-commerce revenue. We have a strategy to grow the engagement in the marketplace and the customer share of wallet and customer engagement and we're using both channels to do that. So we're not targeting a specific growth rate..."

Stephen Wetmore
CEO

"So literally hundreds of initiatives that we have in motion and have identified can now be placed in an organized structured program for execution and tracking. And of course we are continuing our extensive programs targeting internal and external expense reduction."

Stephen Wetmore
CEO

"even operational efficiency programs that generate 20% and 30% return on invested capital are extremely valuable"

Gregory Hicks
President of Retail

"You know where to Steven's opening remarks, we now have hundreds of initiatives identified in size"

Spruce Point
View

Spruce Point is suspicious of these programs, given the company has never figured out how to grow returns beyond 9%

Spruce point believe this sounds "overly ambitious" if not outright unachievable

The Magic \$200 Million “Rule of Thumb”


It seems a strange coincidence that many high profile retailers have announced \$200 million cost savings plans. There are many similarities between Canadian Tire, Sears, JCPenney and Circuit City. All were at one times household names, and great retail success stories. Will Canadian Tire’s story end in a similar fashion?



Sears

JCPenney



Year of cost cutting announcement: \$ in mm	2019	2018	2017	2008
 Cost Savings Plan	C\$200	\$200	\$200	\$200
Cost Savings as % of SG&A	5.8%	5.3%	5.1%	7.3%
Fate	?	Bankruptcy	Financial Distress	Bankruptcy



Spruce Point believes the \$200m is an identical last ditch effort seen at Sears, JCPenney and Circuit City, before things go really bad and each retailer fell into distress. Management’s proclamation that it has “*hundreds of initiatives in motion*” for cost reduction opportunities sounds comical, and begs the question, “*what has management been doing with cost programs up to this point*”?

Shareholders Placing Transformation Hope On Iain Kennedy, An Executive With A Poor History

Iain Kennedy, EVP of Enterprise Technology and Supply Chain, is the key executive leading Canadian Tire's restructuring efforts. We believe investors should question his leadership ability and not give management the benefit of the doubt for CTC's planned restructuring. Iain was a key member of the executive transformation team during the failed turnaround of BlackBerry. Iain was a named executive and EVP of Global Supply at Celestica during a time period when Celestica was accused, and eventually settled, to misleading investors over its restructuring costs.

CFO
Q2'18 Call

"With Iain's expertise, we see the opportunity to capture more process-related operating cost savings through redesign and investment in many of our legacy systems."

BlackBerry Failed Turnaround

[Canadian Tire Website Bio](#)

"He was responsible for **leading the BlackBerry's transformational shift from hardware to software and services**. During his tenure with the company, **Iain was a member of the Executive Transformation Team** with the mandate of transforming the company's product/service portfolio and improving operational efficiencies."

[Iain Kennedy LinkedIn](#)



BlackBerry
4 yrs

Chief Information Officer
2015 – May 2017 · 2 yrs
Waterloo, Canada

As a key member of the Executive Transformation team working with the mandate to transform the Information Technology organization including Corporate Information Technology as well as the Customer facing BlackBerry Enterprise Service Delivery organization. The scope includes the Corporate Application and Infrastructure landscape, as well as customer facing Global Network Operation Centres (NOCs), Global Data Centres, Cloud services, Global Network connectivity as well as Information Security and associated Security Operations Centre (SOC).

Iain claims he was a **KEY** member of the Executive Transformation team

What is not mentioned in the failed outcome of BlackBerry's turnaround and BlackBerry's shares trade at 15 year lows

Celestica Lawsuit Over Restructuring Costs

[Reuters Article \(April 17, 2015\)](#)

Celestica settles U.S. lawsuit over disclosures for \$30 million

NEW YORK (Reuters) - Celestica Inc has reached a \$30 million settlement of a long-running U.S. lawsuit in which shareholders alleged that the Canadian electronics company committed securities fraud by misleading them about its financial health and restructuring costs.

Shareholders alleged that Celestica's stock price had been inflated because the Toronto-based company understated the costs of a 2005 restructuring by as much as 68 percent, understated operating costs, and overstated earnings and revenue.

[Celestica 6-K Filing \(March 21, 2005\)](#)

Iain S. Kennedy

43

Chief Information Officer

Iain was a named executive office at Celestica during the time period mentioned in the lawsuit



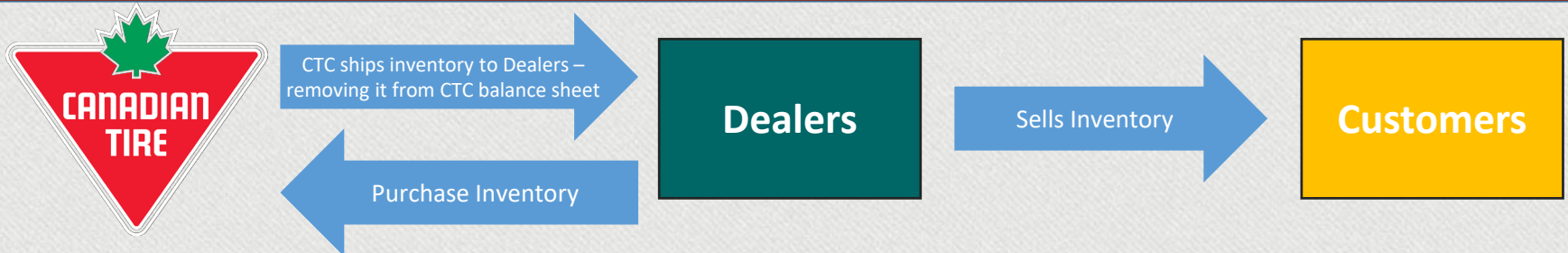
Dealers' Relationship Dynamics

Relationship Between CTC And Dealers

Canadian Tire Retail stores are operated by “Dealers” who own the operations of the individual locations. Dealers purchase inventory and rent the real estate from Canadian Tire. A dealer must invest a minimum of C\$125k into the store, with the remainder financed and guaranteed by Canadian Tire. We estimate total start-up cost of \$3 million. While Dealer loans are backed by CTC, each Dealers’ equity is pooled as collateral, which we believe could present challenges during an economic downturn.

Canadian Tire’s dealer model leads to high turnover as individual dealers typically own only one property. When a dealer wants to sell his/her store, to move up the chain to a bigger store or retire, current dealers are able to bid on other stores based on the amount of sales at his/her current store. The purchase price is determined based on a formula set by CTC and allows for no build up of goodwill.

Inventory



Rent



Dealers Do Default: Full Exposure To Dealers Economics

Canadian Tire Dealer Bankruptcy Filing

[4] Canadian Tire acts as the primary supplier of inventory to dealers. It also leases store sites to dealers. Canadian Tire's relationship with dealers is governed by a Dealer Contract which each dealer executes in favour of Canadian Tire.

Canadian Tire controls the Dealer relationship and has the ability to terminate Dealer contracts

[5] [REDACTED] has been a Canadian Tire dealer since October 4, 1992. He executed various Dealer Contracts, each of which was assigned to [REDACTED] the corporation that operates Store 152. In or around, July 1995, Mr. [REDACTED] commenced operating the Canadian Tire store in Alliston, Ontario where he remained until July 13, 2000. In July 2000, Mr. [REDACTED] then became the dealer at Store 429 in Oakville, Ontario. He remained at Store 429 until August 2, 2006. On August 10, 2006, Mr. [REDACTED] became the dealer at Store 152 in Mississauga and he remains the dealer of Store 152 today, although Canadian Tire delivered a notice on June 1, 2011 terminating the Dealer Contract. [REDACTED] has delivered a notice of arbitration to have the termination declared invalid.

Canadian Tire is exposed to all of the debt and leverage at the Dealer level

[10] In order to run his business, [REDACTED], like other dealers, obtains credit from the following three main lenders, all of which are secured creditors, and each of which provides credit to [REDACTED] for different purposes:

- (i) Franchise Trust, guaranteed by Canadian Tire;
- (ii) CIBC as the operating lender, guaranteed by Canadian Tire; and
- (iii) Canadian Tire.

Guaranteed financing, even during bankruptcy, is instrumental to the business model

[12] Because of the losses suffered at Store 152, [REDACTED] has, since 2006, had a bulge facility in place with CIBC over and above the CIBC operating credit line. That bulge facility is currently \$3.9 million. Canadian Tire has guaranteed this bulge facility.

Dealers Do Default: Financial And Reputational Risk to CTC

Canadian Tire is exposed to the risk of not receiving payment for inventory shipped. Canadian Tire is forced to finance for a period

Canadian Tire Dealer Bankruptcy Filing

[14] On April 20, 2011, Canadian Tire demanded payment by May 2, 2011 of \$1,692,218.68 for outstanding flex payments owed by [REDACTED] for inventory purchases which were in default. Payment has not been made. That outstanding amount for overdue inventory payments owed to Canadian Tire is now \$2.3 million.

Not all Dealer loans are secured

[16] As of May 30, 2011, Canadian Tire's direct exposure to [REDACTED] was over \$12.9 million, consisting of the following items:

(a) Canadian Tire's guarantee of the current CIBC \$3.9 million bulge excess credit facility, which is not supported by inventory, fixed assets, or any other security;

(b) [REDACTED] defaulted debt (as of July 12) to Canadian Tire for inventory, rent, and other flex charges in the amount of \$3,228,629; and

(c) Canadian Tire's exposure of \$5,831,331 in respect of the Franchise Trust Loan, which Canadian Tire is required to purchase from the Franchise Trust if such loan becomes a Defaulted Loan.

MUST purchase defaulted loans

Canadian Tire must choose between increased financial exposure (more risk) or tarnishing the "Canadian Tire" reputation

[24] Canadian Tire contends that if [REDACTED] is unable to pay for inventory when due, Canadian Tire will face the untenable choice between continuing to ship inventory to the store without any reasonable likelihood of payment and insisting on C.O.D. terms for inventory. In the first case, Canadian Tire would be significantly increasing its financial exposure. In the second case, [REDACTED] would likely stop ordering inventory, stock would be depleted, customer needs for products would go unfulfilled, and the Canadian Tire brand and reputation would suffer. I accept the concern of Canadian Tire as valid.

Evidence Of Rising Inventory Levels In Dealer Channels

We observe CTC retail revenue growth has outpaced point of sale (POS) retail sales growth through dealer channels. Based on the gap, we believe Canadian Tire Dealers are unable to quickly turnover inventory to end market customers. Dealers tend to carry a higher level of inventory because of “forward buying,” purchasing from CTC when the item is on promotion and selling at the normal price.

“Stack it high and watch it fly” – Canadian Tire Dealer, when asked about high levels of inventory

Year-over-Year % Growth	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	
Organic CTC Retail Revenue Growth ⁽¹⁾	8.2%	1.4%	5.3%	8.8%	2.8%	3.0%	5.3%	5.3%	2.3%	5.7%	(0.4%)	CAGR: 4.3%
Retail Sales “POS” Growth ⁽²⁾	3.8%	3.0%	5.1%	4.9%	6.4%	3.6%	4.4%	0.8%	3.3%	1.3%	1.0%	CAGR: 3.4%

Amid Signs of Slowing Business, Dealer Inventory Levels CTC Continue Build...

Allan Angus MacDonald
EVP of Retail
Q2 2019 Call
August 8, 2019

“We had strong revenue performance in the quarter and while we were left with some excess inventory versus last year, the vast majority of that has been shipped to dealers in Q3.”

Spruce Point View

Q1 and Q2 2019 days inventory were higher than 2018. The slowdown in CTC’s ability to move inventory to its dealers is a sign of weakness in its retail channel.

Based on our research, Dealers are at Canadian Tire’s mercy. CTC has complete control of product pricing and limits the amount of equity Dealers are able to pull out of their business. What worries us most is CTC’s ability to “kickout” a dealer, not for poor financial performance, but for poor operating performance. This makes us wonder what metrics are considered. Is inventory turnover considered?

(1) Revenue reported for Canadian Tire, SportChek, Mark’s, Petroleum, and Helly Hansen includes inter-segment revenue.

(2) Retail sales refers to the Point of Sale (“POS”) value of all goods and services sold to retail customers at stores operated by Dealers, franchisees, and Petroleum retailers, corporately-owned stores and of goods sold through the Company’s online sales channels.

Source: Company financials, Spruce Point research

Obvious Signs of Financial Strain

A classic sign of potential accounting shenanigans is when accounts receivable are growing faster than reported sales. It is often cited as a top red flag to predict a fraud or accounting scandals.^(1,2) This phenomenon may suggest aggressive revenue recognition practices at best, a change in credit terms to customers, or at worst foul play such as channel stuffing. Over the past 18 months, we observe CTC's Y-o-Y receivables growth significantly outpaced its retail revenue growth.

	Annual							Quarterly						
C\$ in mm	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019
Total Retail Revenue	\$10,381	\$10,692	\$11,305	\$11,075	\$11,453	\$12,121	\$12,814	\$2,507	\$3,180	\$3,310	\$3,817	\$2,564	\$3,360	\$3,296
Y-o-Y % Growth		3.0%	5.7%	(2.0%)	3.4%	5.8%	5.7%		3.0%	11.4%	5.3%	2.3%	5.7%	(0.4%)
Trade and Other Receivables	\$751	\$759	\$880	\$915	\$691	\$681	\$933	\$873	\$552	\$976	\$933	\$987	\$580	\$1,005
Y-o-Y % Growth		1.1%	16.0%	4.0%	(24.5%)	(1.4%)	37.0%		13.3%	20.5%	37.0%	13.1%	5.1%	2.9%

Source: Company financials, Spruce Point analysis

- 1) "How to Predict the Next Fiasco In Accounting and Bail Early", [Wall St Journal](#), Jan 2002
- 2) "How To Detect And Prevent Financial Statement Fraud", [ACFE](#) – Association of Certified Fraud Examiners

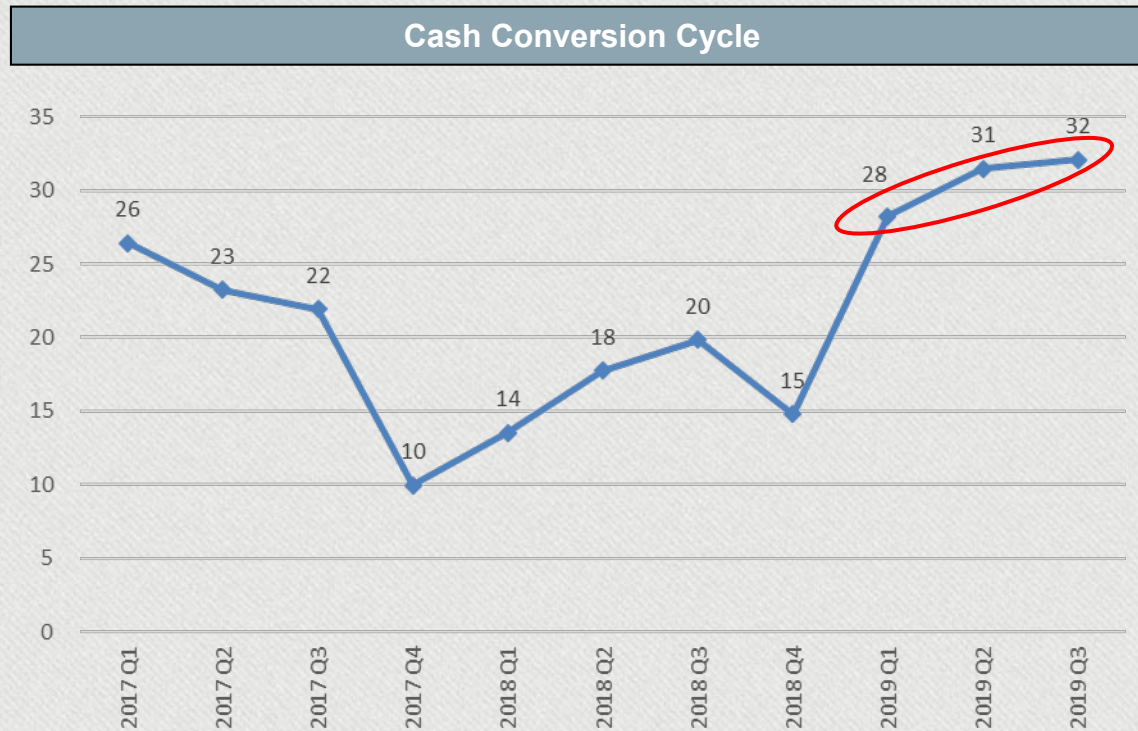
Worsening Days Inventory & Days Payable

We believe the combination of lower dealer sales and the slowing of inventory turnover at CTC are clear signs of financial strains emerging in Canadian Tire's retail business. We observe a Y-o-Y spike in days inventory outstanding for the first three quarters 2019 and believe this is a result of unsold inventory building up in Dealer's stores. During Q1 and Q2, days payable outstanding has declined.

	Annual						Quarterly				Annual	Quarterly		
C\$ in mm	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	FY 2018	Q1 2019	Q2 2019	Q3 2019
Total Retail Revenue	\$10,381	\$10,692	\$11,305	\$11,075	\$11,453	\$12,121	\$2,507	\$3,180	\$3,310	\$3,817	\$12,814	\$2,564	\$3,360	\$3,296
Retail COGS	\$7,546	\$7,680	\$8,034	\$7,748	\$7,891	\$8,392	\$1,726	\$2,253	\$2,308	\$2,579	\$8,865	\$1,770	\$2,406	\$2,273
Trade and Other Receivables	\$751	\$759	\$880	\$915	\$691	\$681	\$873	\$552	\$976	\$933	\$933	\$987	\$580	\$1,005
Merchandise Inventories	\$1,503	\$1,481	\$1,624	\$1,765	\$1,711	\$1,770	\$2,060	\$1,908	\$2,396	\$1,998	\$1,998	\$2,354	\$2,278	\$2,611
Trade and Other Payables	\$2,835	\$3,012	\$3,271	\$3,328	\$3,563	\$3,729	\$781	\$927	\$1,002	\$1,238	\$3,948	\$794	\$955	\$1,023
Days Sales Outstanding	28	26	26	30	26	21	30	20	21	21	23	31	21	22
Days Inventory Outstanding	75	71	71	80	80	76	101	80	85	78	78	112	88	98
Days Payable Outstanding	76	82	86	92	88	89	120	83	86	86	96	115	78	88

Cash Conversion Cycle Deteriorating

CTC's cash conversion cycle (defined as DSO + DIO – DPO) has jumped in the first three quarters of 2019 on both a Y-o-Y and an absolute basis. This is further evidence of weakness in CTC's retail business and another sign of strain on cash flow.





Dealer “True-Ups” Are A True Cost

In the second quarter of 2019, the company cited the relationship with dealers as a negative drag on margin. The company does not disclose many specifics about its relationships with dealers but we believe this is a telling sign of the current pressures dealers are facing. We have reason to believe these “true-ups” were rebates to dealers to compensate for rising minimum wage costs and sluggish retail sales.

Dean McCann, CFO
Q2 2019 Call
August 8, 2019

*“The Retail segment margin rate was not as strong as we would have liked...
We recorded a lower benefit than last year from a true-up related to the margin sharing arrangements with dealers”*

History Of Minimum Wage Increases On Calls

Q4 2009 Call

“Minimum wage increases have hit the dealers a little bit.”

Q2 2017 Call

“Quick comment on the recent announcements regarding minimum wage changes... We can expect them to be a headwind for our corporate stores, primarily Mark's and FGL and for our dealers.”

Q4 2017 Call

“Any time that anything impacts the cost structure, as this would, the dealers are keenly interested in working with us to identify those opportunities and move forward”

Q2 2018 Call

*Question from James Durran (Barclays):
“There's a number of things that are facing all retailers, minimum wage increases... Can you give me an idea, like on the minimum wage side, which is handled by the dealers, like have they been finding ways to offset it?”*

Management never addressed the effect of minimum wage

Dealer True-Ups

Canadian Tire Dealer

“There's certain parameters that people have to look at and say, okay, well did the corporation make enough? Did the dealers make enough as per our agreements? And then they would say, okay, well here's where we would give back. Here's where we would take that kind of thing.”

Spruce Point View

Our belief is that the true-up were a “kick-back” or reversal of the Royalty and License Fee collected from dealers in order to compensate them for slowing business and increased wage expenses. Nothing is disclosed about this mechanism

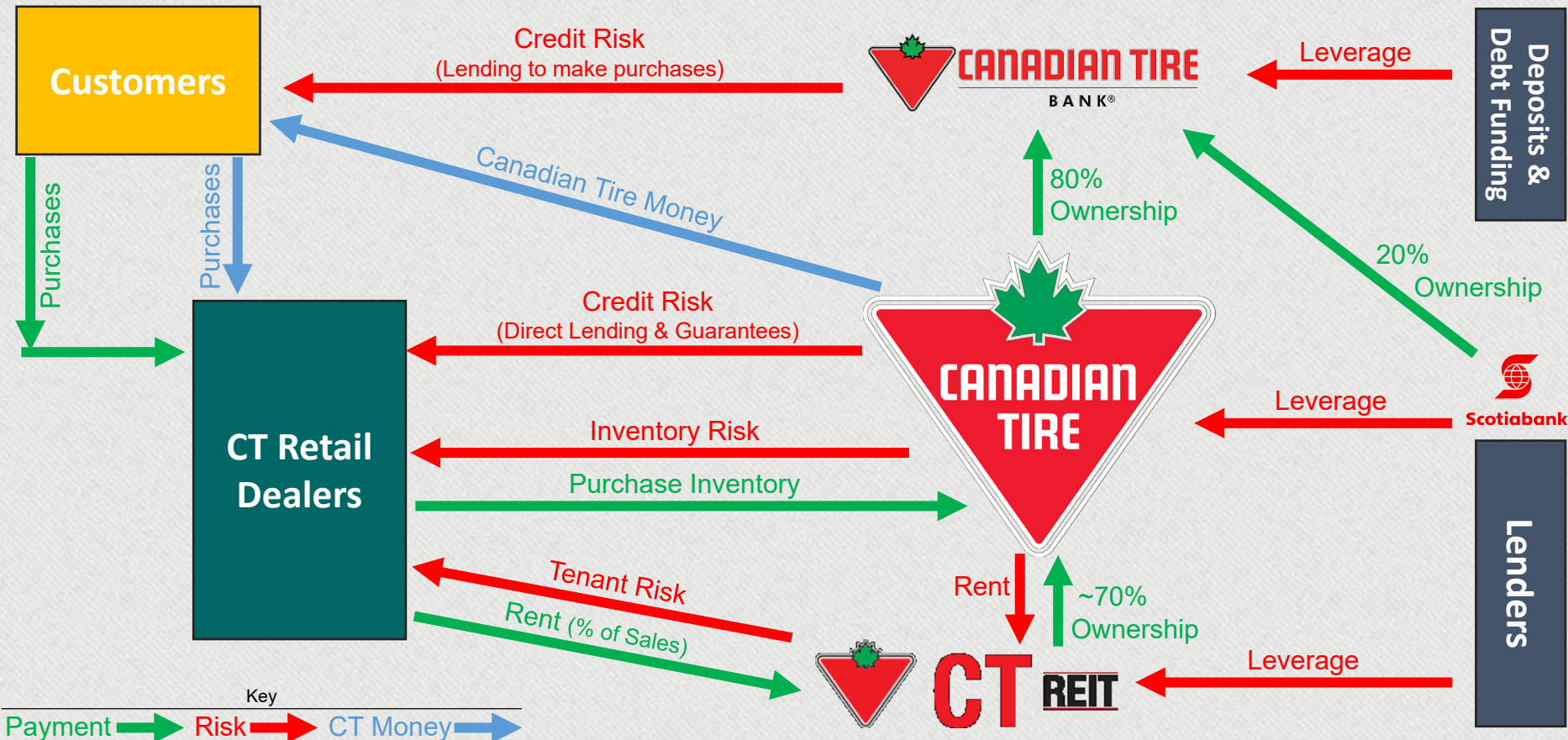


Overleveraged Balance Sheet And High Risk Of Corporate Credit Downgrade

Does The Market Fully Understand This: Overleveraged / Debt Fueled Business Model

Canadian Tire's business model is an interconnected web of risk held by Canadian Tire. The model is highly dependent on debt financing and is a much riskier than a traditional Dealer model.

Canadian Tire Retail Dealers borrow (guaranteed by CTC) to purchase inventory from Canadian Tire and rent locations from CT REIT. The Dealers sell the inventory to customers financed by CT Bank Credit Cards. The customers then receive "Canadian Tire Money" rewards to spend at CT Retail stores, further boosting sales.



Canadian Tire's Dilemma

We believe Canadian Tire will have to choose between: 1) Maintaining its current leverage which will result in a credit downgrade, 2) Returning capital to shareholders or 3) Selling assets (diminishing earnings power) in order to delever its balance sheet. If CTC decides to maintain its current level of capital returns and its goal of reducing leverage, CTC will be forced to sell assets, diluting EPS and shareholders value.

RBC Capital Markets Equity Research Note (October 31, 2019)



Capital
Markets

October 31, 2019

Canadian Tire Corporation

Tire inspection: Reiterating our constructive view ahead of Q3

CTC acting more opportunistically on the 2019 NCIB after crossing lower threshold. As at the end of Q2, CTC had repurchased \$312 MM worth of stock in excess of anti-dilutive purposes toward the planned \$300-\$400 MM buyback for 2019. The pace of repurchases moderated in Q3, with the company active between mid-August and early September, buying back an additional \$8 MM worth in the low- to mid-\$130's. Return of capital is an important part of the CTC story, with ~\$10/share forecast for 2019.

“Return of capital is an important part of the CTC story”

We believe CTC will be unable to maintain its current level of capital return given its current leverage and need to delever in order to maintain its current credit rating

Need To Reduce Leverage To Maintain Current Credit Ratings

Rating agencies have warned that current ratings are based on the anticipated ability to deleverage and sustain a lower level of leverage. Moody's report states that CTC must raise its EBIT/interest coverage ratio – this is concerning for a business which is experiencing declining EBIT margins. Sell-side analysts and equity investors do not pay enough attention to the possibility of a potential downgrade and sell-side analyst publications mention CTC as having a strong capital structure and tremendous financial flexibility. It is prudent for CTC to reduce its leverage to maintain its current rating. A downgrade would result in a rating on the cusp of non-investment grade (junk) status and potentially higher cost of capital.

DBRS Report April 8, 2019

DBRS confirmed the Issuer Rating and Medium-Term Notes ratings of Canadian Tire at BBB (high) with Stable trends. The confirmation of the ratings was based on the Company's stable operating performance in 2018 and the **anticipation of deleveraging** following the partially debt-financed acquisition of Helly Hansen.

Moody's Rating Report June 7, 2019

CTC's commercial paper rating could be downgraded to P-3 if a material weakening of liquidity occurs at any of its three business segments, if a material deterioration occurs in the bank's credit card portfolio quality or capital levels, if a deterioration in Retail market position occurs, reflected by sustained weakening of comparable sales and declining profitability or **if it sustains consolidated adjusted Debt/EBITDA above 5x** (4.8x for LTM Q1/2019) and **EBIT/Interest below 4.5x** (3.9x for LTM Q1/2019).

BMO Corporate Debt August 8, 2019

Credit Metrics Remain Elevated. Total Debt/EBITDAR remained elevated at 3.4x, above DBRS and S&P's thresholds for BBBH. The higher leverage remains due to lower 2019E EBITDA (normalized for IFRS 16) and an increase of total debt of ~\$330M (excluding Financial Services) compared to Q4/18. Pro forma for the acquisition, we estimate leverage of ~3.5x. S&P affirmed its rating and outlook today due to the size of the acquisition [Party City] and management's goal to reduce leverage to 2.5x by the end of 2020, which we believe can be supported by the strength of CTC's free cash flow generating capacity.

S&P Rating Update August 28, 2019

CTC has adopted the revised lease accounting standard. As a result, leverage has increased slightly to 3.5x from 3.2x. We could lower our rating in the next couple of years if we expect CTC to sustain adjusted **debt-to-EBITDA above 2.75x**.

Brian Morrison TD Securities September 11, 2019

We believe that this deal **illustrates CTC's tremendous financial flexibility**, and provides a capital cushion to evaluate additional growth verticals, support its investment-grade status, and potentially return additional capital to shareholders.

Significant Risk Of Credit Downgrade

We believe it will be difficult for CTC to reduce its leverage to the level necessary to maintain its current credit ratings. Equity investors and sell-side analysts are accustomed to a combination of share buybacks and dividend payments. We believe if the Company does not reduce the current capital allocated to buybacks and dividends, CTC will not have the necessary cash flow to reduce its leverage. Investors will be disappointed by the reduction in capital return plans and will be surprised by a potential credit downgrade given sell-side analysts positive view on the Company's financial position.

C\$ in mm	LTM Q3'19
Cash Flow from Operations	\$788
Change in Loans Receivable	\$336
Net Additions to PP&E	(\$351)
Additions to Intangibles	(\$217)
Payment of Lease Liabilities (principal portion) ⁽¹⁾	(\$232)
Distributions Paid to NCI	(\$78)
Payment on Financial Instruments	(\$41)
Free Cash Flow	\$205
Party City Canada Cash Flow (SP estimate)	\$4
Pro Forma Free Cash Flow	\$209
Projected Buybacks	(\$350)
Projected Dividends	(\$243)
Projected Capital Returns	(\$593)
Cash Flow Available to Pay Down Debt	(\$383)

C\$ in mm – All figures exclude financial services	
Net Debt ⁽²⁾	\$3,619
Lease Liabilities	\$2,177
Adjusted Net Debt	\$5,797
LTM Adj. EBITDA (PF for Party City)	\$1,573
LTM Rent ⁽³⁾	\$106
LTM Adj. EBITDAR	\$1,679
Adj. Net Debt/Adj. EBITDAR Leverage	3.45x
LTM Adj. EBITDAR	\$1,679
Target Leverage	2.50x
Total Net Debt Capacity	\$4,199
Required Paydown	\$1,598

Our analysis shows, **CTC does not have the required free cash flow to maintain its current level capital returns and reduce its leverage**

7.5+ years
Required to delever based on LTM FCF and assuming no return of capital to investors
We believe CTC will not be able to reduce its leverage by the end of 2020 without selling assets

1) Reported in cash flow from financing due to IFRS 16 (YTD Q3'19). Q4'18 is reflected in cash flow from operations

2) Net debt adjusted to include purchase of Party City Canada

3) Reflects Q4'18 rent expense and Spruce Point estimated Party City Canada LTM rent

Source: Company financials, Spruce Point analysis

True Exposure Is Significantly Higher

We believe sell-side analysts are underestimating Canadian Tire's total exposure. This explains sell-side comments of CTC's strong financial flexibility while the rating agencies warn of a downgrade without reducing leverage. The most worrying factor is the lack of consistency between analysts' debt calculations. We believe the correct calculation is to consider all Canadian Tire's obligations including each controlled entity and guaranteed third party loans.

C\$ in mm	Spruce Point	TD	Scotiabank	Canaccord	CTC Reported
Bank Indebtedness	\$40	--	\$40	\$40	\$40
Short-Term Borrowings	\$910	\$910	\$910	\$614	\$910
Current Portion of Long-Term Debt	\$538	\$538	\$538	\$1	\$538
Long-Term Debt	\$3,979	\$3,979	\$3,979	\$1,200	\$3,979
Current Portion of Lease Liabilities	\$316	\$316	\$316	\$316	--
Lease Liabilities	\$1,861	\$1,861	\$1,861	\$1,861	--
Short-Term Deposits	\$830	\$830	--	--	\$830
Long-Term Deposits	\$1,667	\$1,667	--	--	\$1,667
Dealer Loan Guarantees ⁽¹⁾	\$661	--	--	--	--
3rd Party Bank Guarantees ⁽²⁾	\$415	--	--	--	--
Total Debt	\$11,216	\$10,100	\$7,644	\$4,032	\$7,963
Cash and Cash Equivalents	(\$226)	(\$226)	(\$600)	(\$600)	(\$226)
Short and Long-Term Investments	(\$349)	(\$349)	(\$349)	(\$349)	(\$349)
Financial Services & REIT Cash	--	--	--	\$442	--
Net Debt	\$10,640	\$9,525	\$7,068	\$3,898	\$7,387
Total Debt / EBITDAR	5.6x	5.1x	3.8x	2.0x	4.0x
Net Debt / EBITDAR	5.4x	4.8x	3.6x	2.0x	3.7x

\$1bn+ of guarantees not included in debt calculations

Leverage is significantly higher than it appears

Note: Q3'19 LTM EBITDAR of \$1,986

Source: Company financials, equity research reports, Spruce Point analysis

1) Dealer loans primarily relate to loans issued by Franchise Trust

2) Guarantees of third-party bank debt agreements

Lost Deposits Requires Increased Borrowings

Canadian Tire's total exposure should include CT Bank. While rating agencies exclude the financial services segment for rating purposes, we believe it is important to consider when analyzing CTC's exposure.

Canadian Tire Bank is heavily funded with high cost, non-sticky broker deposits. This reflects the poor quality and lack of strong customer relationships. In 2017, Canadian Bank Home Capital Group (TSE: HCG) experienced a run on its deposits despite being CDIC (Canada Deposit Insurance Corporation) insured. We believe the fear or questionability of a bank's liquidity given a downgrade could create a similar event at Canadian Tire Bank.

Brokered Deposits Add Risk

[Home Capital – Wall Street Journal Article](#)

THE WALL STREET JOURNAL.

MARKETS

Canadian Lender Draws on Emergency Line as Deposits Flow Out

Home Capital Group stock builds on last week's declines

Despite being CDIC insured, customers rushed to withdraw their deposits from Home Capital amid fraud allegations

Spruce Point View

It is likely customer deposits will decline in the case CT Bank is downgraded to junk status.

Why would depositors take the risk of waiting for a government run insurance program to kick into effect?

Not Following Its Own Objectives Has Led To Poor Allocation Of Capital

Management has not followed its own capital allocation objectives by repurchasing shares instead of using cash to reduce leverage. We believe CTC will struggle to maintain its current credit rating if it continues to execute its announced C\$350m share repurchase program. Since 2018, CTC has been a poor allocator of capital by destroying C\$21m of value through buybacks. Over the past two quarters, while CTC was at 2-year lows, CTC essentially stopped its repurchase program, potentially to preserve cash.

Stephen Wetmore
CEO
2014 Investor Day
October 9, 2014

"I've only come up with five meaningful ways we can use our cash. First, we can invest in our current businesses."

*"Second, we can use our cash to pay down debt and we have. However, **we intend to maintain our investment grade credit rating, which we're already good shape on, and our debt is in great shape as well.**"*

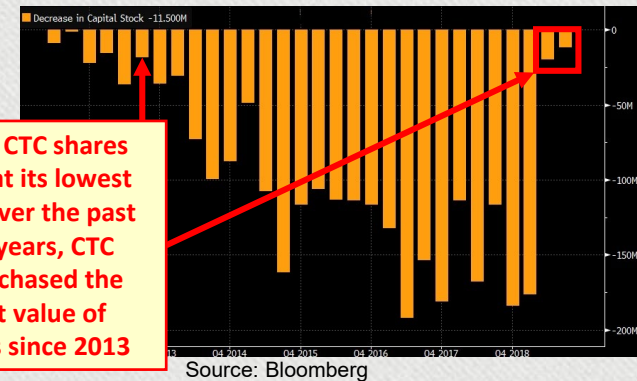
"Third, we can ensure that our dividend payout policy is in line with our peers and especially with our strategy."

"Sure, we're going to want to keep some powder dry for acquisitions as good as Mark's, as good as Forzani, but I believe that we have shown that when our shares are undervalued and we don't have higher value investments, we will return 15 cash to you in the form of share buybacks, share repurchases."

Dean McCann
CFO
Q3 2018 Call
November 8, 2018

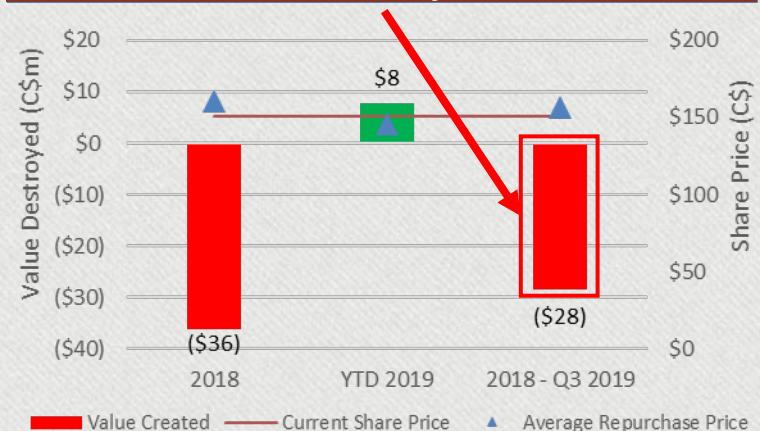
*First and foremost, invest in the business, make sure we **maintain our investment grade rating** and preserve our financial flexibility, and then look at balancing dividend increases and opportunities to return capital to shareholders.*

Management has stated its investment grade rating is a top priority and above capital return. Yet, CTC has continued to buyback shares while its leverage remains above the level required to prevent a credit downgrade



While CTC shares were at its lowest level over the past two years, CTC repurchased the least value of shares since 2013

Poor Allocation of Capital: C\$28m of Value Destroyed Since 2018



Note: Based on current share price of C\$151
Source: Company filings

Counterproductive Actions Are A Signal That CTC Must Delever: Selling REIT Stake

We believe CTC has been divesting its stake in CT REIT due to increased pressure on its balance sheet and high debt load. In September 2019 CTC announced another sale of CT REIT shares. While the credit rating agencies are aware of CTC's current leverage issue, equity analysts have overlooked the problem. TD Securities released a note saying the announcement had no impact on its financial performance and rated the transaction as slightly positive. We believe selling shares, at the expense of EPS, is a negative sign and shows that CTC is in need of capital to delever.

Company Press Release (September 10, 2019)

Canadian Tire Corporation and CT REIT Announce a Joint Secondary and Treasury Offering of CT REIT Units
SEPTEMBER 10, 2019

Brian Morrison – TD Securities (Sep 11, 2019)

We believe that this deal illustrates CTC's tremendous financial flexibility, and provides a capital cushion to evaluate additional growth verticals, support its investment-grade status, and potentially return additional capital to shareholders.

*Last night's announcement has **no impact** on our financial forecasts or valuation; however, we summarize the transaction as slightly positive.*

Source: Equity research reports

Spruce Point View

We view the reduction in REIT ownership as a highly negative sign

Selling down its stake in the REIT is dilutive to EPS and the argument of improving the REIT's liquidity is not rational. Selling down its stake would only make sense in order to delever, sacrificing earnings growth to reduce its debt burden

Coincidentally, CTC's second REIT sale basically offset the money spent on its acquisition of Party City's Canadian assets

If the company states lower EPS due to a reduced interest in the REIT, how is it plausible that reducing its REIT stake has no impact on CTC financial forecasts?

CT REIT Q4 2018 MD&A Risk Section

Significant Ownership by CTC

CTC holds the majority interest in the REIT. In situations where the interests of CTC and the REIT are in conflict, CTC may utilize its ownership interest in, and contractual rights with the REIT, to further CTC's own interest which may not be the same as the REIT's interest in all cases, causing the REIT not to be able to operate in a manner that is to its favour, which could adversely affect the REIT's cash flows, operating results, valuation, and overall financial condition.

REIT's Interests Is Not Completely Independent From CTC:

CT REIT has experienced flat margins as it would not be in CTC's best interest to increase REIT profitability at the expense of other business segments. Over 90% of CT REIT's earnings are a result of rent paid by Canadian Tire stores. The REIT's higher margin is at the expense of CTC's retail business

Counterproductive Actions Are A Signal That CTC Must Delever: Divesting Properties To Raise Cash

It appears CTC is more inclined to sell properties than it was in the past. In 2018 and during the first half of 2019, CTC drastically increased the value of sales. This is concerning given that CTC's debt load has grown substantially over this time. We believe this is a sign the company is strapped for cash.

2018 Annual Report (page 78)

For the years ended (C\$ in millions)	December 29, 2018	December 30, 2017
Cash (used for) generated from:		
Operating activities		
Net income	\$ 783.0	\$ 818.8
Adjustments for:		
Depreciation of property and equipment and investment property (Notes 28 and 29)	301.4	335.0
Income tax expense	285.2	293.7
Net finance costs (Note 30)	151.5	112.6
Amortization of intangible assets (Note 29)	126.6	133.7
(Gain) loss on disposal of property and equipment and investment property	(23.4)	0.4
Change in fair value of redeemable financial instrument (Note 32)	50.0	—
Interest paid	(148.5)	(125.9)
Interest received	10.1	8.7
Income taxes paid	(204.4)	(294.3)
Other	12.0	13.5
Total except as noted below	1,343.5	1,296.2
Change in operating working capital and other (Note 31)	(44.6)	107.0
Change in loans receivable	(491.5)	(430.4)
Cash generated from operating activities	807.4	972.8

After not selling any properties in 2017, CTC divested property in 2018

2019 Second Quarter Report to Shareholder (page 43)

For the (C\$ in millions)	13 weeks ended		26 weeks ended	
	June 29, 2019	June 30, 2018	June 29, 2019	June 30, 2018
Cash (used for) generated from:				
Operating activities				
Net income	\$ 203.8	\$ 174.4	\$ 301.2	\$ 273.5
Adjustments for:				
Depreciation of property and equipment, investment property and right-of-use assets (Notes 12 and 13)	132.9	69.7	266.9	154.7
Income tax expense	57.5	61.9	83.5	94.8
Net finance costs (Note 14)	62.3	32.7	129.3	63.4
Amortization of intangible assets (Note 13)	26.0	32.6	53.4	66.3
(Gain) loss on disposal of property and equipment, investment property and right-of-use assets	(18.0)	0.3	(29.5)	(15.3)
Interest paid	(76.3)	(31.8)	(162.9)	(67.5)
Interest received	4.5	2.2	9.0	4.3
Income taxes paid	(60.6)	(54.1)	(247.2)	(183.1)
Other	4.7	2.0	2.0	5.1
Total except as noted below	336.8	258.9	405.7	396.0
Change in operating working capital and other	446.5	279.8	(290.4)	(190.8)
Change in loans receivable	(243.8)	(233.6)	(37.4)	(124.8)
Cash generated from operating activities	539.5	336.1	77.9	80.4

During the first 6 months of 2019, CTC has already outpaced the entire year of 2018



Increased Credit Risk Is A Major Threat And Is Being Overlooked By The Market

Is Canadian Tire The Next “BIG SHORT”?

In August 2019, Steve Eisman, a portfolio manager best known for his short position against the U.S. credit market in 2008, publicly announced a short position in Canadian Tire. His view on Canadian Tire, and in general Canadian banks, is based on his thesis that the Canadian credit market is deteriorating. He feels the combination of increased loan growth under weaker economic conditions is a red flag. In addition to credit, Canadian Tire’s business is experiencing significant margin pressure.



Steve Eisman’s BNN Bloomberg Interview



Steven Eisman

Senior
Portfolio Manager

Neuberger
Berman

August 23, 2019

*"They have a fairly significant credit card portfolio, which – if I’m right about the credit in the Canadian banks – eventually **those problems will show up in Canadian Tire’s credit card business.**"*

*"As you know, Canadian Tire is a very significant retailer in Canada and I think the last two quarters they’ve had some **real margin pressure**... I think the reason for the margin pressure is they’re feeling the heat from Amazon."*

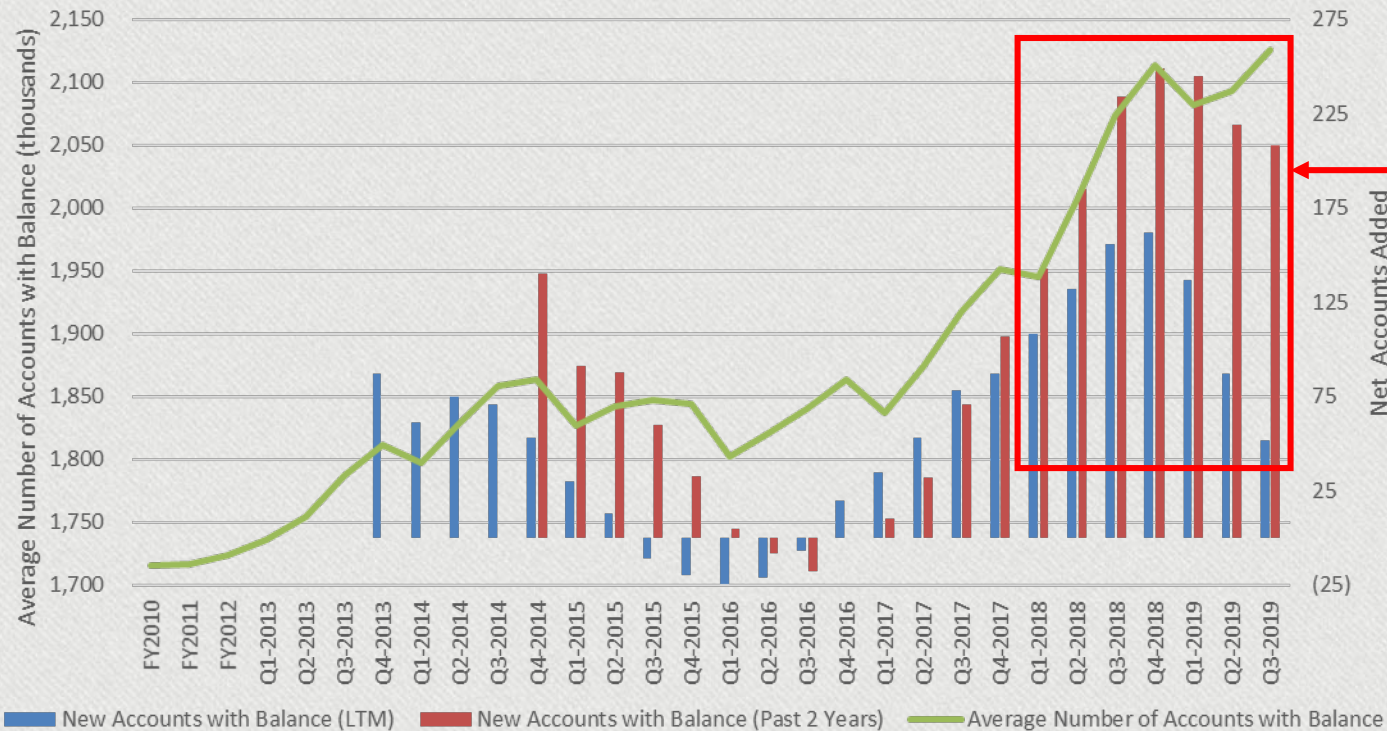
*"It would seem to me with all the uncertainty out there, both in Canada and the world, this would be **the last time in the world you should grow your commercial loan books double digits**, but that’s what the banks are doing."*

"I find it puzzling and unexplainable."

We agree with Mr. Eisman’s comments on the current credit conditions and believe the market has not paid enough attention to Canadian Tire’s credit portfolio

Aggressive Push To Increase Lending

Canadian Tire has made an effort to grow the size of its lending portfolio. CTC's recent rebranding of its rewards program, "Triangle Rewards," was part of a broad push to increase the number of store cards issued. The current magnitude of credit dwarfs prior time periods including leading up to the 2008 financial crisis. As the number of cards have increased, new financial disclosures show growth in higher risk assets. We believe Canadian Tire has loosened its lending criteria to achieve this growth and fuel instore retail sales. Especially at the current point in the credit cycle, this is an extremely risky practice.



The unprecedented growth of the past 4 years will be difficult to sustain. Over the past year, the number of accounts have been flat while the number of new accounts has declined

A majority of the growth over the past 7 quarters has come from **higher risk lending**

Our research shows Dealers are "highly incentivize to encourage customers to use Canadian Tire Credit Cards"

CTC Lends To Higher Risk Customers

Canadian Tire Credit Card customers are typically higher risk given the nature of CTC's business. The typical customer uses a credit card as a source of financing to make a purchase rather than as an easy payment method. Risky customer profiles combined with the continuous growth and evolution of the credit portfolio, leave CTC in a vulnerable position at this stage of the credit cycle. If investors worry about the credit profiles of traditional Canadian banks, they should fear the level of risk in Canadian Tire Bank's credit card portfolio.

Moody's
June 11, 2019

*"We view CTB's asset quality to be of a **higher risk than its peer group**...CTB's credit card franchise is more narrowly linked to the Canadian Tire brand; supporting its Triangle Rewards loyalty program."*

*"We believe CTB's class of credit card customer is higher risk than peers and during an economic stress, **the bank will experience higher than-peer credit losses**... This reflects its chosen market niche of **focusing on customers who primarily use a credit card as a source of financing (revolving balances), rather than payment.**"*

DBRS Report
April 8, 2019

*"CTFS continues to expand its financial services business... While CTC has a long history of prudently managing risk with smaller, tightly focused financial services operation, **continuous growth could lead to the possibility of evolving customer profiles, which may result in additional risk.**"*

Triangle: Aggressive Push To Grow Sales Is The Root Of Credit Problems

Since launching in April 2018, Triangle Rewards has been an aggressive push to drive traffic to Canadian Tire retailers while increasing the number of credit card receivables and accounts. Increased promotions including no fee, no interest; 4% back in Canadian Tire Money; and rewards at Canadian Tire Gas have been part of CTC's broad push to drive traffic to its locations. We believe the push of the financing program is the major root of CTC's credit risk and it is evident by the growth of higher risk loans in CTC's portfolio.

Financing

With a Triangle credit card, enjoy big purchases sooner with **0%-interest** financing*.

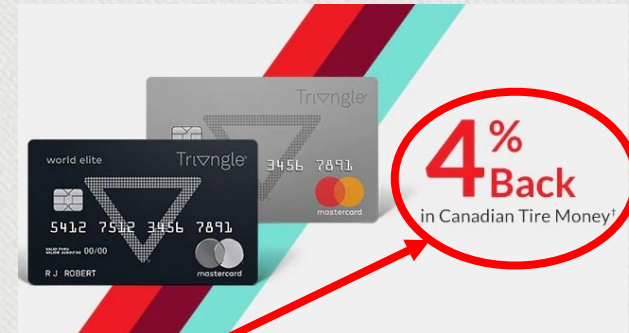


Turn big purchases into small payments.

Finance your purchases through Canadian Tire Bank® with No fee, no interest*. Shop at Canadian Tire, Atmosphere (Quebec), Sports Rousseau, Hockey Experts, L'Entrepôt du Hockey and participating Sports Experts and you can get 12 equal monthly payments when you spend \$200-\$499 and 24 equal monthly payments when you spend \$500 or more.

Shopping our other great retailers?

Get 12 equal monthly payments when you spend \$200 or more at Sport Chek, Atmosphere, and participating Mark's/L'Equipeur and Sports Experts. [Click here](#) for participating stores.



Financing programs and "store cash" rewards at CTC retailers is an aggressive push to increase retail sales

Why would a financially stable customer with good credit borrow for a \$200 purchase?



Offers of 20X-50X bonuses are used to encourage purchases



Turn Big Purchases into Small Payments
No fee. No Interest.*

12
Months

\$200-\$499
purchase

24
Months

\$500+
purchase

Increased Risk Levels Should Be Area Of Concern For Investors

Investors should be concerned by management's comments on the bank business and its push to grow accounts. The CEO of Canadian Tire Bank says he is not concerned about the level of risk in the portfolio despite attracting new customers and the continuous growth of "high risk" and "moderate risk" assets. 68% of Y-o-Y growth has been in high and moderate risk categories.

Management Is Not Concerned With The Level Of Risk... But You Should Be

Q1 2019 Call
August 8, 2019

Emily Foo
BMO

"Great, then as a follow-up, your credit card past due rates increased a little bit, by about 20 basis points sequentially from Q4. Does that concern you, or is that just noise?"

Gregory Craig
President & CEO
Canadian Tire Bank

"No, I think—well, obviously we keep a really close eye on all of our credit risk metrics. **We're not concerned about the level of risk in the portfolio.** What I would encourage you to do is look at March to March, because there is a seasonality with allowance rates as you come off of Christmas and the receivables are at a high. Typically, you'll have your allowance needs a bit higher in March, so I would look at the 11-basis point—the rate is higher by 11 basis points compared to March of last year, and that's frankly come down from what we've seen in December, so we're very comfortable with where we are from a risk perspective."

Yet the Year-over-Year Change in Risk Categories Show Increased Risk

C\$ in mm	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Total \$ Growth	% of \$ Growth
Low Risk	\$2,046	\$2,240	\$2,192	\$2,330	\$2,089	\$2,331	\$2,469		
\$ growth y-o-y					\$43	\$92	\$277	\$412	31.9%
% growth y-o-y					2.1%	4.1%	12.7%		
Moderate Risk	\$1,934	\$1,978	\$2,037	\$2,116	\$2,104	\$2,138	\$2,068		
\$ growth y-o-y					\$170	\$160	\$31	\$360	27.9%
% growth y-o-y					8.8%	8.1%	1.5%		
High Risk	\$1,614	\$1,635	\$1,759	\$1,803	\$1,856	\$1,835	\$1,834		
\$ growth y-o-y					\$243	\$199	\$75	\$517	40.1%
% growth y-o-y					15.0%	12.2%	4.3%		

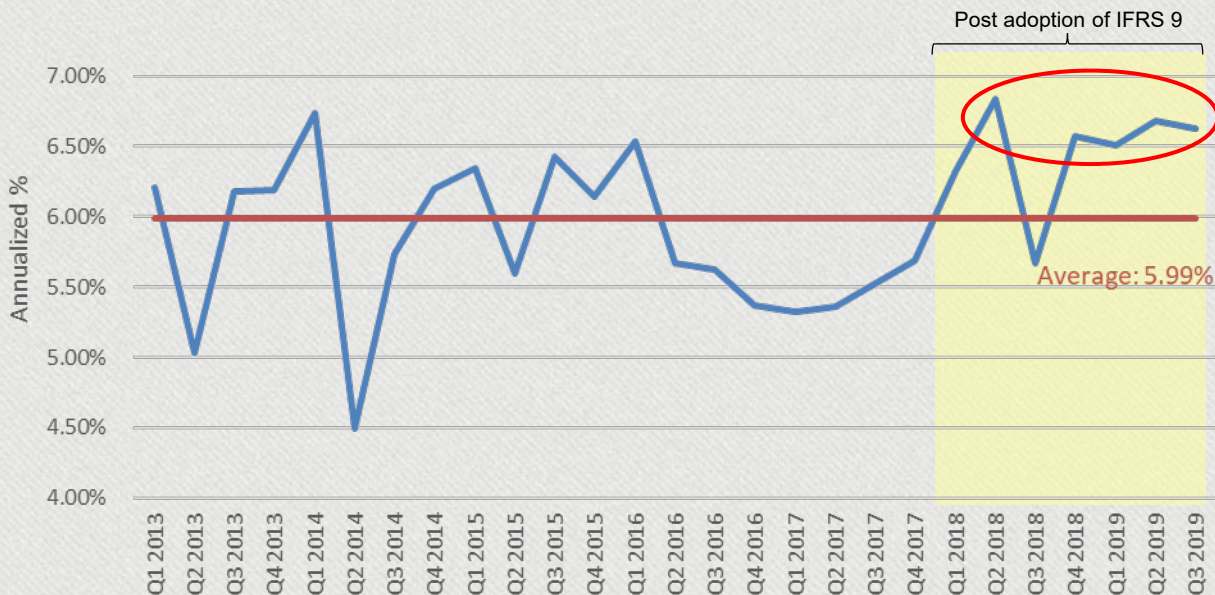
**High and Moderate Risk
Accounted for a Combined
68% of Y-o-Y Growth**

Increase Of Higher Risk Credits Should Result In Growing Impairments

Net impairments have continued to rise since the adoption of IFRS 9 in January 2018. We believe this is a result of the growth in loans categorized in CTC's higher risk buckets. This should be a red flag for investors as CTC's rapid growth has been achieved through increased risk. CTC provides limited disclosure on the credit quality of its portfolio. CTC does not disclose credit metrics for the overall portfolio including borrowers' credit score.

Expected Credit Losses Are Continuing To Rise

Net Impairment Loss As A % Of Credit Card Loans



Impairments continue to rise post the adoption of IFRS 9

Spruce Point View

In order to continue growing its credit portfolio, CTC has increased its lending to higher risk and subprime borrowers. This is extremely risky at the current late stage in the credit cycle

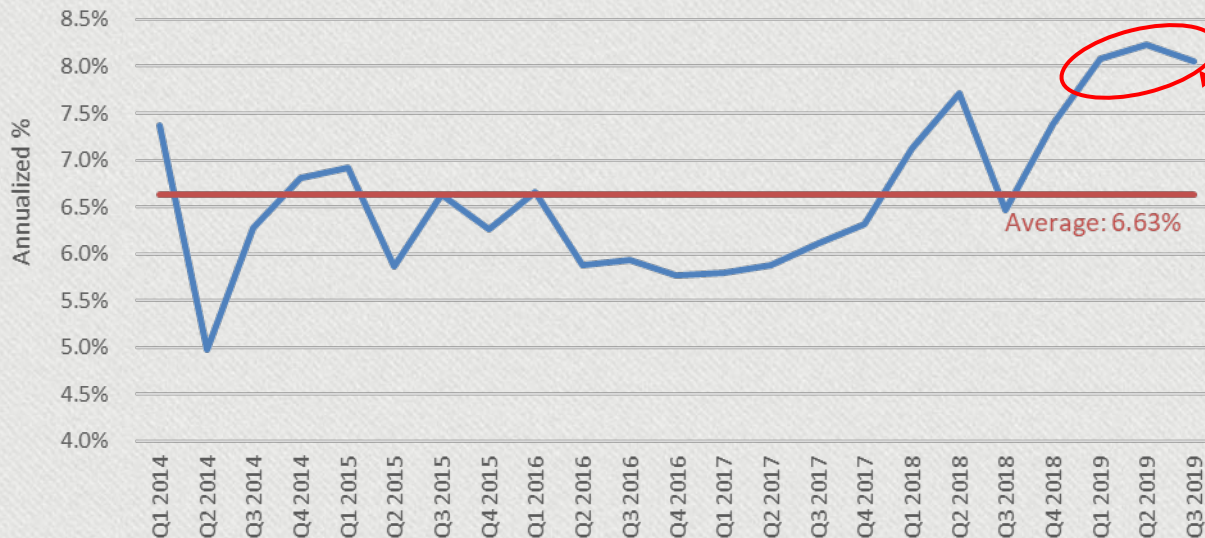
“Seasoned” Losses Show Deterioration In Credit Quality

While the overall charge-off rate is in-line with past peaks, this is misleading because of high loan growth. Using a “seasoned” (loans over 1 year old) charge-off rate allows for consistency, accounts for the 180 days required for a loan to be delinquent, and factors in no defaults within the first year ⁽¹⁾.

Canadian Tire has been experiencing an increase in losses on its “seasoned” loans.

“Seasoned” Credit Losses Are Worse Than Overall Portfolio Appears

Net Impairment Loss As A % Of “Seasoned” Credit Card Loans⁽²⁾



“Seasoned” charge-off rate is above recent historical peaks

We believe the rise in CTC’s “seasoned” charge-off rate is worrying and is a leading indicator of future credit problems, especially given the fact the CTC’s newer credits are higher risk

- 1) Alliance Data Systems (Bank of America Conference transcript; September 17, 2008): “what you will see is anytime there is a new vintage of cards out there, the first year, there are no losses. And then what happens is it spikes up to 10% or 12%. And then it cleans out the junk. And it comes back down to your 6.5%. That’s called a vintage.”
- 2) We calculated this metric as the ratio of net impairment losses to CTC’s credit card portfolio balance in the prior year

Deterioration Worse Than Peer Banks

While it is clear that Canadian Tire has riskier assets due to the nature of its credit card business and profile of its card users, the relative change in Canadian Tire's delinquency rate has performed worse than peers over the past 2 years. This is a sign of a weak credit portfolio which we believe should worry investors.

Canadian Tire Credit Card Portfolio's Delinquencies Have Performed Worse Than Canadian Banks Over The Past 2 Years

90+ Day Credit Card Delinquencies



Over the past 2 years, Canadian banks have continued to see a decline in delinquencies. However, during the period, CTC's delinquencies have remained flat. The gap between CTC and Canadian Banks shows a relative weakness in CTC Credit Card Portfolio

We believe "seasoned" losses would show a greater delta between CTC and peer banks



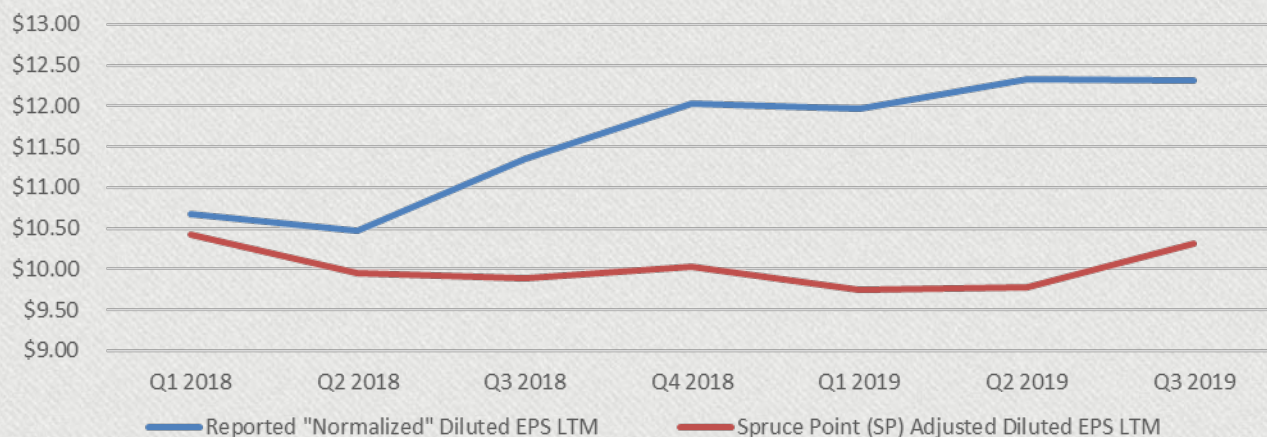
Canadian Tire's Reported Earnings Are Potentially Misleading Investors

Reported EPS Does Not Provide Investors With A Clear Picture Of The Underlying Growth

We believe Canadian Tire's reported EPS does not reflect its underlying organic growth.

By removing what we believe are unsustainable benefits to EPS, the gap between our Spruce Point adjusted EPS and the reported EPS widens.

Reported vs Spruce Point Adjusted LTM EPS



C\$	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019
<u>Reported</u>							
Reported "Normalized" Diluted EPS LTM	\$10.67	\$10.47	\$11.36	\$12.03	\$11.97	\$12.33	\$12.32
LTM Normalized EPS Growth Y-o-Y				12.0%	12.2%	17.8%	8.5%
<u>Spruce Point Adjusted</u>							
Spruce Point (SP) Adjusted Diluted EPS LTM	\$10.43	\$9.95	\$9.89	\$10.02	\$9.74	\$9.78	\$10.26
LTM SP Adjusted EPS Growth Y-o-Y				(6.7%)	(6.6%)	(1.7%)	(9.6%) ⁽¹⁾

1) Growth rate based on reported Q3'18 LTM EPS
Source: Company financials, Spruce Point analysis

Adjusting For Unsustainable Benefits To EPS

Our adjusted EPS figures remove what we believe to be unsustainable benefits to EPS. After considering these adjustments, the company's underlying organic EPS growth is performing worse than at face value. We believe as the positive accounting benefits from these adjustments wear off, the true underlying EPS trend will become apparent to investors. The Q3'19 Y-o-Y decline in reported EPS reflects the roll off in the benefits from CTC's financial engineering.

C\$	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Comment
Reported "Normalized" Diluted EPS	\$1.18	\$2.61	\$3.47	\$4.78	\$1.12	\$2.97	\$3.46	
<i>Normalized EPS Growth Y-o-Y</i>	(5.3%)	(7.2%)	34.2%	16.4%	(4.9%)	13.9%	(0.4%)	
<u>Spruce Point Adjustments</u>								
Helly Hansen Net Income	--	--	0.29	0.22	0.06	(0.00)	--	Based on CTC financials
Interest from Helly Hansen Deal Funding	--	--	(0.08)	(0.08)	(0.09)	(0.09)	--	Reverse interest expense on new debt
Share Repurchases	0.06	0.11	0.15	0.20	0.06	0.14	0.38	Normalizing for reduced share count
<u>Change in Depreciation Method</u>	(0.05)	0.18	0.19	0.21	0.17	--	--	1 time hit in Q1 '18; benefit after
<u>Gains on Sale of Properties</u>	0.18	--	--	--	0.15	0.23	--	Infrequent and unpredictable large sales
Lower (Higher) Effective Tax Rate	0.06	(0.02)	(0.03)	(0.08)	0.07	0.18	0.02	Normalizing for effect of changing rate
Adoption of IFRS 16	--	--	--	--	0.05	0.05	0.05	Net impact of IFRS 16
<u>Reduction in Allowance for Loan Receivable</u>	--	--	0.17	--	--	--	--	Change of credit loss model assumptions
<u>Change in Present Value of Credit Recoveries</u>	--	--	0.25	0.07	--	--	--	Change in management estimates
Interest Income from Overpayment of Taxes	--	--	--	--	--	0.09	--	Interest from overpayment of taxes
Total Spruce Point Adjustments	\$0.24	\$0.28	\$0.94	\$0.54	\$0.47	\$0.60	\$0.45	
Spruce Point (SP) Adjusted Diluted EPS	\$0.93	\$2.33	\$2.53	\$4.24	\$0.65	\$2.37	\$3.01	
<i>SP Adjusted EPS Growth Y-o-Y</i>	(25.0%)	(17.1%)	(2.3%)	3.2%	(30.5%)	1.8%	(13.3%) ⁽¹⁾	

1) Growth rate based on reported Q3'18 EPS
 Source: Company financials, Spruce Point analysis

Recent Benefits Helped To Hit EPS Guidance

Canadian Tire's EPS guidance of 10%+ established in Q4 2017 has been achievable due to various benefits that have potentially mislead investors to CTC's true underlying EPS growth. Earlier this year, CTC added a new footnote to its investor presentation stating its EPS guidance is based on normalized results. To us, it is clear CTC would not have achieved its guidance without various "normalized" adjustments and other unsustainable items.

Q3 2017 Earnings Call Presentation – November 9, 2017 (slide 10)

Financial Aspirations

THREE YEAR FINANCIAL ASPIRATIONS 2018 - 2020^{1,2}

Financial Aspirations ³		Select Material Assumptions ³
Consolidated Same Store Sales Growth (excluding Petroleum) (annual aspirations)	3%+	Customer base will grow across all banners utilizing a One Company for One Customer strategy Each individual business unit expected to contribute positively to aspiration
Diluted earnings per share (EPS) (average annual increase over three year period)	10%+	Successful rollout of operational efficiency programs and initiatives No major changes to the Company's financial leverage and capital allocation approach
Return on invested capital (aspiration by end of 2020)	10%+	Realization of Consolidated Same Store Sales Growth and Average Annual Diluted EPS Growth aspirations

- 1 – Established on November 9th, 2017
 2 – Forward looking information – refer to slide 2 for additional information
 3 – Refer to Section 13.0 of the Q3 2017 MD&A for additional information of the Company's three year financial aspirations

THIRD QUARTER FINANCIAL RESULTS | 2018 – 2020 FINANCIAL ASPIRATIONS

2018 Investor Presentation – April 1, 2019 (slide 33)

Financial Aspirations

THREE YEAR FINANCIAL ASPIRATIONS 2018 - 2020^{1,2}

Financial Aspirations³

CONSOLIDATED COMPARABLE SALES GROWTH (EXCLUDING PETROLEUM) (annual aspiration)	3%+
DILUTED EARNINGS PER SHARE ⁴ (EPS) (average annual increase over three year period)	10%+
RETURN ON INVESTED CAPITAL (aspiration by end of 2020)	10%+

- 1 – Established on November 9th, 2017
 2 – Forward looking information – refer to slide 2 for additional information
 3 – Refer to Section 5.1 of the 2018 MD&A for additional information of the Company's three year financial aspirations
 4 – Based on normalized results

2018 INVESTOR PRESENTATION | FINANCIAL ASPIRATIONS 2018 – 2020

CTC has changed its capital structure by reducing its share count and increased debt since issuing the original guidance

CTC's recent investor presentation has added an important footnote stating that EPS guidance is "based on normalized results"

- 1 – Established on November 9th, 2017
 2 – Forward looking information – refer to slide 2 for additional information
 3 – Refer to Section 5.1 of the 2018 MD&A for additional information of the Company's three year financial aspirations
 4 – Based on normalized results

The Street Will Be Caught By “Surprise”

The sell-side is assuming the Company is able to continue pulling additional levers to benefit earnings. In the absent of these one-time benefits, CTC would be required to grow EPS 25% to hit street targets. Investors will likely be disappointed as recent one-time benefits begin to roll off and CTC’s underlying earnings struggles are made clear.

C\$ in Bn (except EPS)	FY 2018	FY 2019E	FY 2020E
Operating Profit, adjusted	\$1.27	\$1.49	\$1.57
% Growth		17.2%	5.4%
Pre-tax Profit, adjusted	\$1.07	\$1.08	\$1.15
% Growth		1.4%	6.5%
Net Income, adjusted	\$0.69	\$0.78	\$0.83
% Growth		12.8%	6.0%
EPS, adjusted	\$10.64	\$12.91	\$14.17
% Growth		21.4%	9.7%

Note: Estimates as of 12/3/2019
Source: Bloomberg

C\$	EPS
2019E Spruce Point Adjusted EPS ⁽¹⁾	\$11.40
2020E Wall Street Consensus EPS	\$14.17
Implied Y-o-Y EPS Growth	<u>24.3%</u>

It appears sell-side analysts’ growth estimates are giving CTC the continuous benefit of its unsustainable accounting tricks

1) Spruce Point Q4’19E EPS based on Wall Street consensus estimate of \$5.37



Aggressive Accounting Practices

Pressure From The Top To “Hit Numbers”

Canadian Tire’s CEO has stressed the importance that “hitting numbers” is a clear goal of management. Pairing his comments with CTC’s accounting changes since 2016, it seems there is reasonable motivation by management to alter historic accounting methods and assumptions in favor of increased earnings. Investors should take note of management’s willingness to use these accounting changes to influence EPS.

Canadian Tire CEO Stephen Wetmore’s Earnings Call Comments Regarding “Hitting Numbers”

Q2 2016 Call
August 4 2016

*“We always look at the numbers in the following way. That if we put great numbers up, we're in control, and if you don't have good numbers, then the outside world ends up being in control. **If we want to stay on our agenda, we have to continue to hit our numbers.**”*

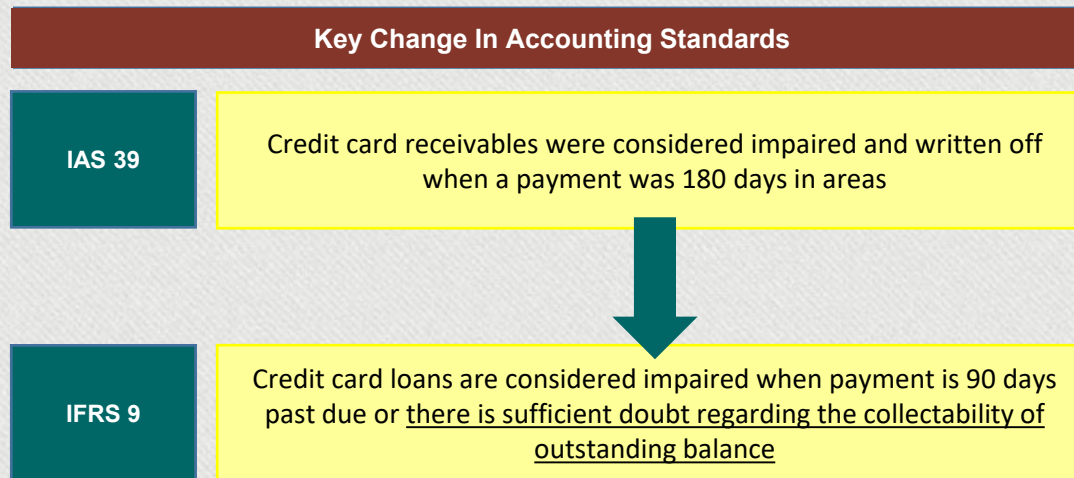
Q2 2019 Call
August 8, 2019

*“Yes. I mean we put our aspirations out a few years ago, I guess it was, for performance and bottom line and ROIC performance. **It's extremely important we hit those numbers**, but it was more important in our Operational Efficiency Program overall that we drove what's necessary for our customer experience. That, bar none, had to be the number one priority both from a digital point of view and from our ability to collect data and analyze it and use it in the proper way...*

*So now's the time. We've got things up and running. We feel quite confident, and so now is the time to push it, **but we have to hit those numbers**. It's what we published and it's how we expect ourselves to perform.”*

Understanding The Change in Accounting Standards For Recognition of Credit Losses

To understand the reversal in Q3 2018, it is important to understand the change of IFRS standards in Q1 2018. As part of the adoption of IFRS 9 in January 2018, CTC is required to report higher credit card provisions earlier in the life of the loan. IFRS 9 requires provisions to be based on the expected credit loss over the life of the loan rather than as losses occurs. CTC made a \$584m catch-up adjustment to account for the change but this adjustment did not impact net income or EPS.



Two Quarters Later, In Q3 2018...



CTC made two credit related accounting changes and realized an EPS benefit from the adjustments

Credit Assumption Changes In Q3'18 Resulted In Increased Earnings

Management made TWO major changes to its credit-related accounting assumptions in Q3'18 resulting in a boost to earnings for the remainder of the year. First, the company changed model assumptions of the allowance for expected credit loss (ECL) resulting in a one-time benefit of \$15m in Q3'18. Second, the company changed its estimate of present value of recoveries on charged-off credit cards, resulting in a \$21.4m positive impact to earnings in Q3'18. We estimate a ~\$6m positive impact in Q4'18.

Company Press Release (November 8, 2018)

FINANCIAL SERVICES OVERVIEW

- Gross average credit card receivables was up 11.2% over the prior year.
- Revenue grew 10.5% over the prior year.
- Income before income taxes increased 31.6% in the third quarter to \$131.9 million partially due to:
 - a \$21.4 million year- to-date adjustment booked in the quarter relating to the positive impact of a change in Management's estimate of the present value of future recoveries; and
 - a \$15 million reduction in the incremental allowance for loans receivable due to improved customer default rates compared to the original expected credit loss model assumptions.

2018 Third Quarter Report to Shareholders (page 17)

Gross Margin

Gross margin dollars increased 19.0 percent due to higher credit charges from strong GAAR growth, the favourable impact from a change in Management's estimate of the present value of regular recoveries resulting in a year-to-date adjustment of \$21.4 million, and a \$15 million reduction in the incremental allowance for loans receivables due to improved customer default rates compared to the original ECL model assumptions (which resulted in a decrease in the allowance rate of 20 bps). This was partially offset by increased regular and insolvency write-offs. The allowance rate, which has increased from approximately 2.0 percent last year to 12.4 percent this year, is within the previously disclosed projected range of 11.5 to 13.5 percent.

CTC's press release cites the reason for the reduction in the incremental allowance as **"improved customer default rates"** despite the quarterly report mentioning **"increased regular and insolvency write-offs"**

Dean McCann
CFO
Q4 2018 Call
February 14, 2019

*"The impact was relatively minor in the quarter. When we changed the methodology with respect to how we record recoveries from a cash basis to an accrual basis, we did that in Q3 as we talked about at that time. We said there would be a spillover effect into Q4. **It's probably a few million bucks on the write-off rate**, and we've disclosed that in the MD&A, in the schedule, the mice print below the, if you will, the table."*

Spruce Point
View

Based on our research, we estimate that the Q4 effect was ~\$6m – far from "a few million bucks" the CFO mentioned on the call

Depreciation Method Change Positively Impacted Reported Earnings In Future Quarters

In Q1 2018, CTC changed its depreciation accounting method and took a one-time charge for accelerated depreciation. This resulted in a one-time loss for Q1 but offered a benefit to EPS for the following quarters. Sell-side analysts added back the one-time expense in Q1 but overlooked the benefit to EPS for the remainder of the year.

2017 Company MD&A (page 41)

11.1.1 Change in Accounting Estimates

The following represents forward-looking information and users are cautioned that actual results may vary.

Based on an analysis of the Company's assets, which was completed in Q1 2018, the Company believes that the straight-line method of depreciation better reflects the pattern of consumption of the economic benefits of its assets. As a result, the Company intends to change its depreciation method to straight-line for all of its depreciable assets that were previously depreciated using the declining balance method.

This change will be considered a change in accounting estimate in accordance with IFRS and as such will be accounted for prospectively. It is expected that the change in estimation methodology will result in a one-time charge (due to accelerated depreciation) in Q1 2018 of between \$15 million to \$20 million. In addition, under the straight-line methodology the Company expects that the ratio measuring its annual depreciation expense as a percent of consolidated revenue will decrease by approximately 40 to 50 bps. The ratio may also vary due to among other items, the timing and type of assets coming in and out of service and fluctuations to capital expenditures and revenue.

Has CTC's asset base really changed?

By not restating earnings, EPS growth will appear faster over the next period

Spruce Point estimates the change resulted in an **~18c – 21c** positive quarterly impact to EPS for Q2 – Q4 2018 based on the mid-point of company guidance

Multiple Changes To Accounting In 2016

In 2016, management made 2 changes to its accounting assumptions related to the financial services segment. First, CTC lengthened the estimated period for amortization of deferred loan acquisition costs which helped boost near term profitability in the financial services segment. Second, CTC made a favorable change to its estimate for future recoveries from insolvency proposals.

2016 Annual Report (page 31)

Revenue

Revenue of \$270.2 million increased \$5.7 million, or 2.2 percent, primarily driven by higher credit card charges (due to higher yield and increased GAAR) and the positive impact related to a change in Management's estimate of the amortization period for loan acquisition costs; partially offset by lower insurance revenue.

Gross margin

Gross margin dollars increased 8.9 percent and the gross margin rate increased 370 basis points during the quarter primarily due to favourable credit card portfolio aging which led to a decrease in the allowance for future write-offs and the positive impact of a change in Management's estimate of future recoveries from insolvency proposals.

We view the two changes made in 2016 and the emergence of management's aggressive accounting practices to increase CTC's reported earnings



Weaknesses In Corporate Governance Practices & Bearish Insider Activity

Lack Of Disclosure Around Credit Agreements

Canadian Tire and CT REIT do not disclose their credit agreements to investors and keeping their debt structures opaque. We believe this is a highly suspicious practice and makes us wonder why the Companies would not disclose these documents. CTC's capital structure secrecy is not new. In Q1'14, CTC's CFO would not respond on the record to an analyst's question about targeted capital structure and leverage ratios.

Sedar.com Database

Company Search: Canadian Tire
Industry Group: All
Document Selection: Material Contracts

Sorted: By Issuer
Date From: January 1 2012
Date To: November 18 2019

Search results 0-0

Company Name	Date of Filing	Time of Filing	Document Type	File Format	File Size
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No search results for "Material Contracts" filled by CTC on Sedar

Given Canadian Tire's dependence on leverage to fuel its business model, how are its credit agreements not "Material"

CT REIT 2016 Annual Information Report

17. MATERIAL CONTRACTS

Copies of the foregoing documents (save and except for the Bank Credit Agreement) have been filed with the Canadian securities regulatory authorities and are available on SEDAR at www.sedar.com.

CT REIT states they do not disclose its Bank Credit Agreement despite being what we believe to be a common practice

On CTC's Q1'14 Earnings Call, CFO Dean McCann Preferred to Answer Offline

Irene Nattel (RBC)
Q1 2014 Call

"So just was wondering if you could share your thoughts around what is the appropriate capital structure for that business? What kind of leverage ratios you might feel okay with? And how you might reverse that net cash position?"

Dean McCann
CFO
Q1 2014 Call
May 8, 2014

"I think maybe we should take some of that offline. But I would say... As we've mentioned many times, we're very committed to protecting our credit ratings and debt metrics. And that's what really drives what we would like to see with respect to a capital structure. There's no question that our balance sheet is exceptionally strong right now... And in terms of the detail, Irene, I think it's better to do that offline with you, if that's okay."

Why would a company with opaque disclosures want to take an answer about leverage ratios and capital structure offline?

Opaque Adjustments

Short-Term Incentive Plan (STIP) compensation is based on STIP earnings. CTC does not disclose the adjustments used to calculate STIP earnings from reported net income. Based on CTC's disclosure, management has a role in determining STIP earnings by reviewing and presenting what they believe to be appropriate adjustments. We do not believe this is a strong corporate governance practice.

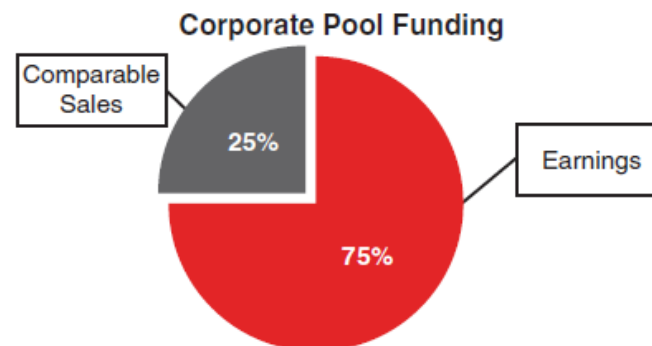
2018 Compensation - [2019 Management Information Circular \(page 50\)](#)

Corporate Pool Funding

CTC's total STIP pool is based on earnings (weighted 75% of the overall pool) and comparable sales (weighted 25% of the overall pool). CTC's target STIP earnings (*Target STIP Earnings*) and target STIP comparable sales (*Target STIP Comparable Sales*) are established based on the Company's business plan, which is approved by the Board.

After the fiscal year is completed, management reviews the Company's financial results and presents to the MRC Committee matters affecting earnings and comparable sales that were not part of the business plan and that may require adjustment. After the MRC Committee decides on any appropriate adjustments, actual earnings (*Actual STIP Earnings*) and actual comparable sales results (*Actual STIP Comparable Sales*) are compared to the Target STIP Earnings and Target STIP Comparable Sales, respectively, and the Corporate Pool Funding (defined below) is calculated as set out below.

At the end of the year, the pool available for the allocation of individual STIP awards (*STIP Pool*) is determined by multiplying the sum of the target STIP awards for all eligible Executives by a percentage (*Corporate Pool Funding*). This funding percentage is based on the degree of achievement of Target STIP Earnings and Target STIP Comparable Sales.



Unclear Calculation Of Compensation

We believe there may be a meaningful gap between STIP earnings and CTC's true organic earnings power. The company does not provide adequate disclosure of its calculation for STIP earnings. Based on the disclosed gap, we believe there are a number of items not being accounted for, driving higher compensation for executives.

2018 Compensation - 2019 Management Information Circular (page 51)

Payout	Threshold (35%)	Target (100%)	Maximum (200%)	Payout %
Performance ⁽³⁾				
STIP Earnings ⁽¹⁾ (as % of target)	\$690.1 (92%)	\$750.1 (100%)	\$810.1 (108%)	76.1%

Company Reported STIP Earnings

C\$ in mm	2018
Net Income	\$783.0
Implied Company Adjustments	\$54.9
STIP Earnings	\$728.1

Based on our calculation of Adjusted Net Income, management would have been below the threshold of \$690m required to receive a bonus under CTC's STIP

Spruce Point Adjusted

C\$ in mm	2018
Net Income	\$783.0
Spruce Point Adjustments	
Helly Hansen Net Income (net of financing cost)	\$22.4
Change in Depreciation Method	\$33.8
Gains on Sale of Properties	\$11.7
Reduction in Allowance for Loan Receivable	11.1
Change in Present Value of Credit Recoveries	\$20.3
Total Spruce Point Adjustments	\$99.3
Spruce Point Adjusted Net Income	\$683.7

\$44 million Delta

Spruce Point View

Canadian Tire needs better disclosures regarding the calculation of its executive compensation plan

Chairwomen's History With Hollinger Fraud

Maureen Sabia was a Director of Conrad Black's Hollinger, a member of the audit committee and corporate governance and compensation committee. Fraud charges were brought against Hollinger and the Company filed for bankruptcy in 2007. Ms. Sabia was a member of the audit committee during the end of the period where the fraudulent actions took place.

SEC Press Release (November 15, 2004)

SEC Files Fraud Charges Against Conrad Black, F. David Radler and Hollinger Inc.

FOR IMMEDIATE RELEASE
2004-155

Relief Sought Includes Penalties, Officer and Director Bars, and Imposition of Voting Trust on Hollinger, International Shares Held by Black and Hollinger, Inc.

Washington, D.C., Nov. 15, 2004 - The Securities and Exchange Commission announced today that it has filed an enforcement action in the U.S. District Court, Northern District of Illinois, against Hollinger International's former Chairman and CEO Conrad M. Black, former Deputy Chairman and COO F. David Radler, and Hollinger, Inc., a Canadian public holding company controlled by Black.

The Commission's complaint alleges that from approximately 1999 through 2003, Black, Radler and Hollinger Inc. engaged in a fraudulent and deceptive scheme to divert cash and assets from Hollinger International, Inc., a U. S. public company and a subsidiary of Hollinger, Inc., and concealed their self-dealing from Hollinger International's public shareholders.

Management Proxy Circular (2003)

- (1) Lord Black is the Chairman of the Executive Committee of the board of directors. Messrs. Colson, Gotlieb and Radler are members.
Mr. Ketcham is the Chairman of the Audit Committee. Messrs. Eaton, Fullerton and Gotlieb and Ms. Sabia are members.
Mr. Gotlieb is the Chairman of the Corporate Governance Committee. Mr. Eaton and Mr. Fullerton are members.
Mr. Ketcham is Chairman of the Compensation Committee. Messrs. Eaton, Fullerton and Gotlieb and Ms. Sabia are members.
Mr. Boulton is Chairman of the Retraction Price Committee. Mr. Atkinson is a member.

Is Canadian Tire's Chairwoman paying the same amount of attention to Canadian Tire's activities as she did to Hollinger?

We wonder what level of scrutiny is being applied to Canadian Tire's aggressive accounting practices and management's proposed STIP compensation earnings

Multiple Recent Insider Resignations

Over the past ten months, four key executives (CFO, VP and two Directors) have reigned or given notice. This is a bearish signal to the market. In February, CTC's current CFO announced his plans to leave at the end of the year and CTC has yet to announce a replacement.

Executive	Title	Date of Departure	Date Hired	Reason / Note
Timothy Price	Director	October 4, 2018	2007	Retired from the Board
Anatol Van Hahn	Director	May 2019	December 2015	Declined to stand for re-election in May 2019. Former Group Head of Scotiabank's Canadian operations ⁽¹⁾
Linda Drysdale	VP, FP&A	October 2019	September 2008	Led FP&A for CTC cross banner functional groups. Led staff of 59. Former CFO of Canadian Tire Bank
Dean McCann	EVP & CFO	December 31, 2019	1996 (CFO since 2012)	Retired from CTC To remain on CT REIT Board

**CTC has yet to announce a
replacements for the CFO position**

1) Scotiabank owns 20% of Canadian Tire Bank
Source: Company website, LinkedIn



Board Member Diana Chant Does Not Want To Own Any More Than Required

Diana Chant's, an Audit Committee member, recent activity has given us reason to believe she is focused on owning the minimum number of shares required for her position as a Director. In December 2018, she purchased \$51k worth of shares, bringing her year end total to ~C\$474k. We believe this purchase was made in order to get her back over the C\$465k required amount. In August 2019, she purchased an additional C\$50k worth of shares – presumably to keep herself above this year's minimum ownership threshold. Ms. Chant received ~C\$230k of cash compensation for 2018.



December 13, 2018
Purchased 350 shares for ~C\$50k
2018 Year end ownership: C\$473,919

NOTICE OF ANNUAL MEETING OF
SHAREHOLDERS MAY 9, 2019 (page 11)

MARKET VALUE OF
TOTAL NUMBER
OF SHARES
AND DSUs⁽³⁾

\$473,919

**Her ownership came in just
above the minimum
requirement**

August 13, 2019
Purchased 370 shares for ~C\$50k

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS MAY 9, 2019 (page 38)

Director Share Ownership Guidelines

To ensure that directors' interests are aligned with those of CTC's shareholders, demonstrate that directors are financially committed to CTC through personal share ownership and promote CTC's long-standing commitment to sound corporate governance, under our Director Share Ownership Guidelines, every director who is not an employee or officer of CTC is required to accumulate at least three times the value of the annual director retainer (which as at the Company's fiscal year end was \$465,000) in Common Shares, Class A Non-Voting Shares and/or DSUs, by the fifth anniversary of becoming a director. Directors holdings are calculated on their fifth anniversary based on the greater of: (i) the acquisition cost of the Common Shares, Class A Non-Voting Shares and DSUs; and (ii) the market value of such shares and DSUs based on the closing share prices on the TSX on the last day of the calendar quarter prior to each director's applicable guideline achievement date.

**Where will the Director's minimum be for year end 2019?
How should other shareholders feel if a member of the Board
only wants to own the bare minimum number of shares**

Dual Share Class: No Accountability

Canadian Tire's dual share class structure (voting Common Shares and non-voting Class A Shares) is destructive for shareholders value. CTC's non-voting shares allow management and the Board to hide from accountability. The Billes Family uses the dual share class structure to maintain control over the business its family founded almost 100 years ago. It is clear this is a disservice to other shareholders. We believe the share class structure has resulted in CTC's poor performance and left management and the Board without any accountability.

Paul Singer's Financial Times Opinion

Opinion Corporate governance

Do not let company founders hide from accountability

Lyft's dual class structure will prevent shareholders from having reasonable input

PAUL SINGER [+ Add to myFT](#)

That is because shareholder accountability is often the best corrective for a company that has lost its way. In my experience, this is especially true in the technology sector, where enthusiasm for dual-class structures runs highest.

My firm, Elliott Management, frequently encounters technology companies where founders or longtime managers created remarkable innovations but then struggled with the challenges of maturing products, expanding organisations or slowing growth.

They often respond by aggressively seeking new sources of growth, paying richly for acquisitions that do not fit with their business models or allocating capital towards peripheral activities that fail to generate returns. Worse, such efforts often damage the core businesses that brought success in the first place.

CTC has made questionable, failed acquisitions and recent share repurchases which we believe have destroyed shareholders value

Mondaq Article

Benefits of a Dual Class Share Structure for Family Businesses

Dual-class share structures for public companies are controversial and the debate has been raging for a considerable time.[3] The principal arguments against such structures are based on notions of shareholder democracy and protection of minority rights. Perhaps as a result, the number of publicly traded companies in Canada with a dual-class share structure has dropped from 100 in 2005 to 69 in 2018.[4]

Nevertheless, the benefits of such structures identified by IGOPP and other commentators may be of particular interest to family-run businesses. Superior voting rights permit families to plan and manage their businesses in the long term and facilitate generational change, while, at the same time, being able to access outside investor capital to support the growth of the business. The dual-class structure affords protection against hostile take-overs and what IGOPP perceives as shareholder activism driven by short-term (and perhaps short-sighted) profit maximization. Or, as put by IGOPP: "... the coupling of dual-class and family ownership brings about longer survivorship, better integration the social fabric of host societies, less vulnerability to transient shareholders and more resistance to strategic and financial fashions."

While a dual share class structure benefits the controlling family, it is not in the best interest of all shareholders and overall corporate governance

Generations have passed since the original founders controlled the business. Current leadership has not successfully navigated the changing retail environment



Valuation And Downside

Spruce Point Estimates 35% – 50% Downside

Valuation	Low Price	High Price
Retail 2021E Retail FCF <u>FCF to Equity Multiple</u> Retail Equity Value Value Per Share (A)	\$225 <u>7.0x</u> \$1,575 \$25.57	\$275 <u>10.0x</u> \$2,750 \$44.64
CT REIT REIT Share Price <u>Shares Owned by CTC</u> Value of REIT Ownership Value Per Share (B)	\$15.25 <u>158</u> \$2,403 \$39.01	\$15.25 <u>158</u> \$2,403 \$39.01
Financial Services (CTFS) CTFS Book Value Book Value Multiple CTFS Equity Value Less: 20% Minority Interest <u>Value of CTC Stake (80% Ownership)</u> Value Per Share (C)	\$989 <u>1.0x</u> \$989 (\$198) \$791 \$12.84	\$989 <u>1.25x</u> \$1,236 (\$247) \$989 \$16.05
Combined Value Per Share (A+B+C) <i>Upside / (Downside)</i>	\$77.42 (48.7%)	\$99.70 (34.0%)

Spruce Point Estimates Vs. The Street

Bay Street analysts are very bullish on Canadian Tire despite numerous headwinds that face the business. CTC will continue struggling to gain market share in its traditional retail market resulting in slowing sales growth and margin pressure. Financial Services' growth should expect headwinds from slowing accounts growth. Sell-side analysts are giving CTC full credit for the announced cost savings plan, and we have strong inclinations to question the true level of cost saving opportunities at Canadian Tire.

<i>C\$ in mm except per share amounts</i>	Market Assumptions	Spruce Point Reality
<u>2020E Segment EBITDA</u>		
Retail	\$1,758	\$1,555
REIT	\$387	\$380
Financial Services	\$432	\$410
<u>2021E Segment EBITDA</u>		
Retail	\$1,912	\$1,590
REIT	\$406	\$370
Financial Services	\$442	\$425
Cost Cutting	\$200	\$100
Price Target	\$167	~\$77-\$100
<i>Upside / (Downside)</i>	11%	(35%-50%)

Note: Spruce Point estimates rounded to nearest 5. Upside / Downside based on current share price of C\$151

Source: Bay Street Estimates, Spruce Point analysis

Retail Segment Free Cash Flow

<i>C\$ in mm</i>	2018	LTM Q3'19	2019E	2020E	2021E
Reported Retail EBITDA	\$1,026	\$1,467	\$1,595	\$1,555	\$1,590
Payment of Lease Liabilities (principal portion) ⁽¹⁾	--	(232)	(295)	(295)	(295)
Property Sales	(26)	(30)	(30)	--	--
Distribution Income from REIT	(131)	(126)	(120)	(125)	(130)
Adjusted Retail EBITDA	\$868	\$1,081	\$1,150	\$1,135	\$1,165
Retail Working Capital ⁽²⁾	(\$48)	(\$302)	(\$320)	(\$205)	(\$210)
Capital Expenditures	(439)	(458)	(460)	(475)	(495)
Estimated Taxes ⁽³⁾	(154)	(144)	(155)	(150)	(155)
Cash Interest on Retail Debt ⁽²⁾	(45)	(52)	(55)	(55)	(55)
Other Items ⁽⁴⁾	14	27	25	25	25
Retail FCF	\$197	\$151	\$185	\$275	\$275

1) Reported in cash flow from financing due to IFRS 16 (YTD Q3'19). Q4'18 is reflected in cash flow from operations

2) Spruce Point estimate based on CTC financial disclosures

3) Based on segment EBT and 25% tax rate

4) Other items includes finance leases, interest income and capitalized borrowing costs

Note: Spruce Point estimates rounded to nearest 5

Source: Company financials, Spruce Point analysis

Retail Sector Comps

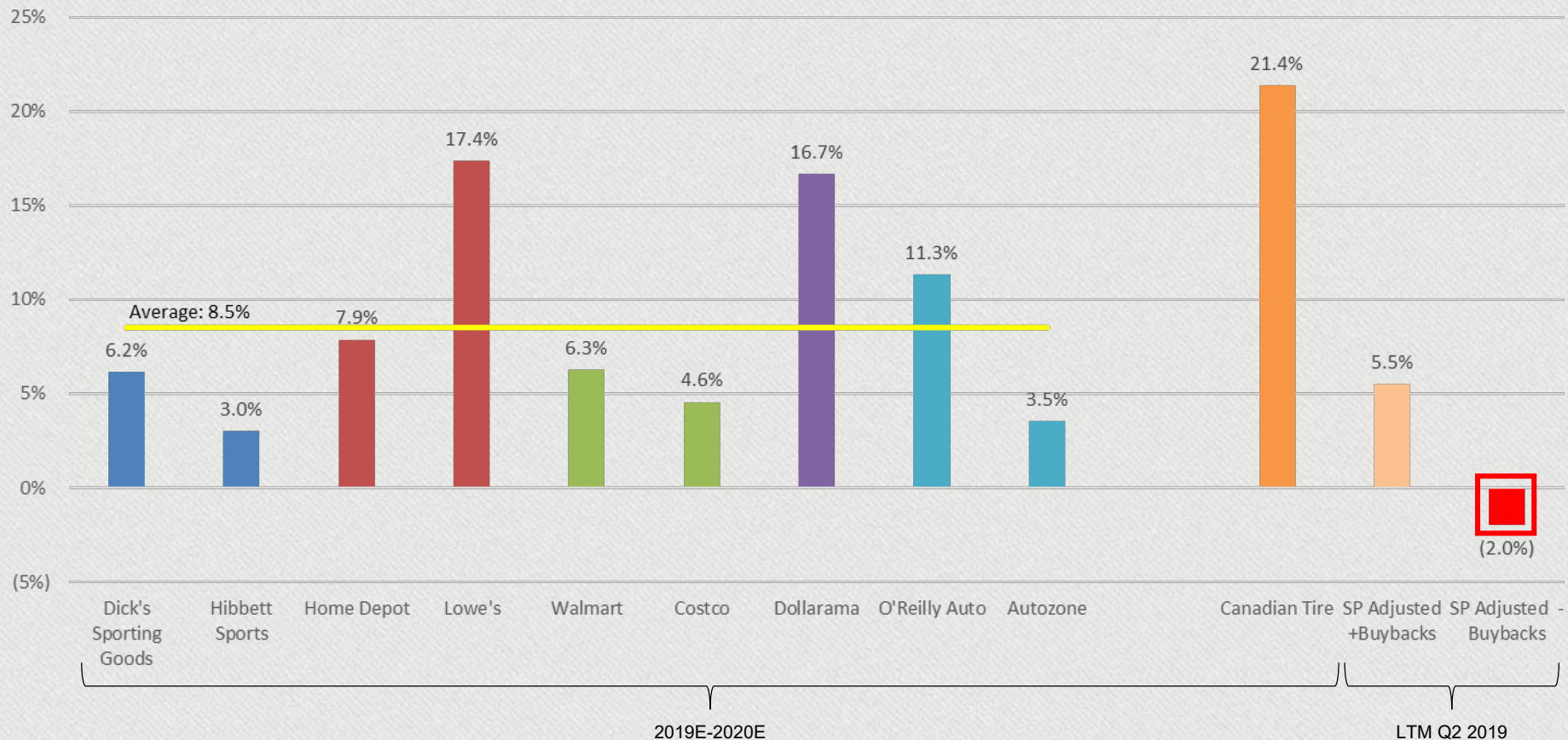
Although Canadian Tire may appear cheap compared to retailers on a P/E and EBITDA multiple basis, this is the incorrect way to value Canadian Tire given its unique business model. Canadian Tire's retail segment EBITDA is potentially misleading due to its poor cash flow conversion, and we believe evaluating it on a cash flow basis is a much more accurate representation of Canadian Tire Retail's fair value.

In US\$

	Stock Price	Adj Ent.	2019E Gross	2019E EBITDA	2019E OCF	'19E-'20E		'20E-'21E				Enterprise Value							
						Sales	EPS	Sales	EPS	P/E		EBITDA		Sales		OCF	Price/	Net Debt	Dividend
Name (Ticker)	12/4/2019	Value	Margin	Margin	Margin	Growth	Growth	Growth	Growth	2019E	2020E	2019E	2020E	2019E	2020E	2019E	Book	19E EBITDA	Yield
Sporting / Outdoor Goods																			
Dick's Sporting Goods	\$45.75	\$7,521	29.2%	8.0%	4.6%	2.0%	6.2%	2.5%	7.2%	12.8x	12.1x	10.7x	10.6x	0.9x	0.8x	19.0x	2.3x	5.1x	2.4%
Hibbett Sports	\$27.17	\$657	32.5%	7.5%	0.0%	(1.3%)	3.0%	NA	NA	10.8x	10.5x	7.5x	7.5x	0.6x	0.6x	9.2x	1.4x	2.0x	NA
Home Improvement																			
Home Depot	\$214.10	\$267,083	34.1%	16.2%	0.0%	4.3%	7.9%	4.6%	8.8%	21.2x	19.7x	15.0x	14.2x	2.4x	2.3x	19.2x	NM	1.8x	2.5%
Lowe's	\$115.46	\$110,270	31.9%	10.8%	6.5%	2.9%	17.4%	3.2%	13.8%	20.3x	17.3x	14.1x	12.8x	1.5x	1.5x	23.4x	36.2x	2.7x	1.9%
US Mass Merchant																			
Walmart	\$118.69	\$413,572	24.1%	6.2%	5.4%	3.1%	6.3%	2.8%	6.1%	24.2x	22.8x	12.6x	12.2x	0.8x	0.8x	14.6x	4.3x	2.1x	1.8%
Costco	\$296.52	\$129,223	11.0%	4.2%	3.5%	7.1%	4.6%	7.0%	7.6%	35.4x	33.8x	18.8x	18.5x	0.8x	0.8x	22.7x	8.4x	(0.4x)	0.9%
Canadian Variety																			
Dollarama	\$33.62	\$12,084	43.6%	29.4%	19.8%	7.8%	17.3%	6.8%	12.7%	25.0x	21.3x	14.4x	13.1x	4.2x	3.9x	21.4x	NM	1.7x	0.4%
Hudson Bay	\$6.95	\$6,741	37.4%	6.6%	NM	0.3%	NM	0.6%	NM	NM	NM	16.5x	15.0x	1.1x	1.1x	NM	1.7x	12.2x	0.5%
Auto Focused																			
O'Reilly Auto	\$442.09	\$39,639	53.1%	21.8%	17.1%	5.9%	11.3%	5.2%	11.8%	24.7x	22.2x	17.9x	16.9x	3.9x	3.7x	22.9x	204.7x	2.5x	NA
Autozone	\$1,163.09	\$34,118	53.6%	21.6%	17.1%	2.9%	3.7%	4.4%	9.7%	18.3x	16.3x	13.2x	12.9x	2.9x	2.8x	16.4x	(17.0x)	1.9x	NA
		Max	53.6%	29.4%	19.8%	7.8%	17.4%	7.0%	13.8%	35.4x	33.8x	18.8x	18.5x	4.2x	3.9x	23.4x	204.7x	12.2x	2.5%
		Average	35.1%	13.2%	8.2%	3.5%	8.6%	4.1%	9.7%	21.4x	19.6x	14.1x	13.4x	1.9x	1.8x	18.7x	30.3x	3.2x	1.5%
		Min	11.0%	4.2%	0.0%	(1.3%)	3.0%	0.6%	6.1%	10.8x	10.5x	7.5x	7.5x	0.6x	0.6x	9.2x	(17.0x)	(0.4x)	0.4%
Canadian Tire	\$113.64	\$13,818	40.7%	14.5%	8.0%	1.5%	21.4%	4.6%	9.7%	11.7x	10.7x	8.7x	8.2x	1.3x	1.2x	15.6x	1.3x	3.7x	3.0%

CTC's EPS Growth Is Worst-In-Class When Excluding The Effect Of Buybacks

Canadian Tire's core organic EPS growth is the worst among its peers, and trails the peer set average when including the effect of buybacks. Despite weak historical performance, the Street has 2019E EPS growth significantly above CTC's peers. We believe the Street's 2019E EPS is unattainable.



Sell-Side Estimates Show Limited Upside & Do Not Reflect Appropriate Downside Risk

Sell-side analysts are not exceedingly bullish on Canadian Tire. With multiple Buy/Hold ratings and only one Sell recommendation, it is clear the majority of analysts are not factoring in the true balance sheet leverage and abundant credit risk. Desjardins recently lowered its price target from a street high C\$196 to C\$175 when a new analyst took over coverage. We believe that when a new analyst with a fresh perspective looked at CTC, he found the existing price target to be overly optimistic. We believe there is a big divergence between the consensus of analysts' projections and the Company's likeliness for a reduction in capital return plans. Based on our research, analysts' estimates are overly optimistic given the current pressures CTC's business is facing. Analysts have ignored the gross margin effect of Helly Hansen and potentially have overlooked the true size of retail's gross margin contraction.

Canadian Tire Sell-Side Price Targets		
Firm	Rating	Price Target (C\$)
RBC	Outperform	190
TD	Buy	190
Accountability Research	Buy	180
Desjardins	Buy	175
CIBC	Outperform	173
National Bank Financial	Outperform	173
Scotiabank	Sector Perform	164
Canaccord Genuity	Hold	160
BMO	Market Perform	159
Morningstar	Hold	147
Veritas	Sell	127
Average Price Target		\$167
Upside		11%



The Long Term Potential Of Canadian Tire Is...

