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EDITED TRANSCRIPT

CTC.A.TO - Q1 2017 Canadian Tire Corporation Ltd Earnings Call

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PRESENTATION

Operator

Good afternoon. My name is Melanie, and I will be your conference operator today. At this time, I would like to welcome everyone to the Canadian Tire Corporation Limited First Quarter Results Conference Call. (Operator Instructions) Earlier today, Canadian Tire Corporation Limited released their financial results for the first quarter of 2017. A copy of the earnings disclosure is available on their website, and includes cautionary language about forward-looking statements, risks and uncertainties, which also apply to the discussion during today's conference call.

I will now turn the call over to Stephen Wetmore, President and CEO. Stephen?

Stephen G. Wetmore - *Canadian Tire Corporation, Limited - CEO, President and Non-Independent Director*

Thank you, Melanie, and good afternoon, everyone. I'm going to leave most of the numbers and comments on the quarter to Allan and Dean, but I would like to congratulate the team in another strong quarterly performance.

Despite being our smallest retail quarter, our retail segment generated revenue growth of 8.5%, and we had solid IBT growth of 4.3% from our Financial Services business, all contributing to the strong diluted earnings per share growth of 37.8%, which generated -- we generated on a year-over-year basis. You may remember my comments last quarter about how when things are going well, we take all the credit, but when weather is a factor, then clearly, it's not our fault. So you won't be surprised when I tell you that I view Q1 as a good quarter, however, there were weather influences that impacted our customers, as the typical activity patterns were disrupted by a warmer January and February and a colder March across the country.

Despite these challenges, we did some -- we did show some growth over the prior year, both CTR and Mark's. However, our customers' buying severance were totally disrupted this quarter at FGL Sports, leading to a decline in comp store sales in the quarter. We were quite concerned within our inventory build going into the quarter, so despite the lack of sales growth, we have ended the quarter in good shape from an inventory point

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of view. Not having excess inventory also meant that we did not have to chase sales at FGL, and we maintained our year-over-year margin performance.

Staying with FGL for a moment. I know you're going to ask if the first quarter performance is indicative of a slowdown in FGL's top line growth and the short answer is no. We have completed the 5-year plan, 2 million square feet real estate expansion during that period. And while we still have a substantial pipeline, it is inevitable that we will see its growth slowing as we go forward. However, many of the operational initiatives put in place at Canadian Tire Retail are now being implemented at FGL, as we move to phase 2 of FGL's growth agenda. FGL completed the rollout of the new point-of-sale system in Q1, and are now live with their distributed order management system. So I believe Duncan and the team now have the foundation that the company has needed.

Financial Services had a good quarter, and I should note that this is Greg Craig's first quarter as President of Canadian Tire Financial Services, so I'm sure that he is relieved that the business performed well, and of course, I'm very pleased with the President he has set for future quarters.

Earlier today, we had our Annual General meeting and I don't want to cover the same ground with you here. However, we are making very good progress on many fronts in laying the foundation for our future, and we'd be pleased to expand on any area during our Q&A session today.

So with that, let me turn the call over to Allan MacDonald, and let him share with you some of the progress at Canadian Tire Retail. Allan?

Allan Angus MacDonald - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

Thanks, Stephen. Good afternoon, everyone. Earlier today at our AGM, Stephen spoke about our move to operating as one company with one customer and the importance of data and analytics within the business. On today's call, Stephen asked me to add some color to his comments and update you on how this is progressing.

Not so long ago, CTR was very silent, focused purely on product sales. Automotive, for example, focused on its high-risk customers, petroleum and gas customers, even though both owned a car. The flyer was simply a shared tool for each business to promote its particular products. The website was operated by IT, and CTFS manages its business without any partnership at retail. We hadn't really contemplated the power of working together. Our customers were identified by their loyalty to a category, not their loyalty to CTR.

So how we've turned it around despite owning some of these challenges, working collaboratively, focusing on one customer to grow our share of wallet? We've also become completely engaged in moving CTR to becoming a data-centric company. Virtually every aspect of our business is engaged in empirical decision-making.

A few examples. CTR and CTFS collaborated to drive credit card acquisition, transactions on the card and OMC share of tendered stores. In the past 2 quarters, we've acquired 28% more credit card accounts than we did in 2016. Options MasterCard share of tendered CTR grew by 11.5% and customer sales using our in-store financing grew by over 54%.

CTR and our consumer brands division had committed to growing strategic categories through owned brands. Kitchen is a brand-driven category and our 8% penetration of owned brands in kitchens pales in comparison to the 88% we have in Christmas. So we're excited this week to announce the acquisition of Paderno. It'll be a big part of our effort to grow Canada's kitchen story. In terms of analytics, until recently, our data was plentiful, but multiple data warehouses made it inaccessible and disorganized at best. It's been a very difficult nut to crack. It wasn't until we built new tools to access the data and stop looking for insights and started asking good questions, that a light appeared at the end of the tunnel. Now the floodgates have opened, and here, I have to thank Mahes Wickramasinghe. He's been a huge help, a pioneer and a driving force behind this cultural shift.

Since the beginning of 2016, we've made excellent progress. Our teams' analysis of product purchases concluded traffic-driving products, are not always obvious. Historically, we use transactions as a proxy for traffic, but now, we have statistical models that show how categories behave. Not all traditional traffic drivers are as valuable as we once thought. Imagine the day when someone told you lost leaders aren't actually important to your most valuable customers. This empirical analysis is being applied to our assortment planning and merchandising, and have played a major role in our promotional productivity.

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We're also using data analytics in our marketing, thanks to new capabilities to match loyalty data and online traffic. We can better understand how online search influences in-store traffic, all at a person, product, and store level. We've uncovered important drivers of online engagement, like speed, search patterns, and how to effectively format product and category information. Hundreds of improvements to the site have led to customer exit rates, for example, decreasing by as much as 60 percentage points. We have improved product search speed by 75%, delivering search results faster and more accurately. Today, we announced some new initiatives that will continue our progress with CTC business units working together, building stronger relationships with a common customer and cooperation -- cooperating on operational best practices.

I'm really excited about introducing the Pro Hockey Life brand to Canadian Tire stores and Canadiantire.ca. I think this allows us to really create the best hockey assortment and format for each community, again, thinking about the customer and bringing our best Canadian tire to them. We also announced we'll be testing Mark's products at Canadian Tire. This one, for me, is an obvious one. We both sell footwear and apparel, and while Canadian Tire has the traffic, Mark's owned brands that are among the most innovative and highest-quality in the world, so it's a natural collaboration.

And last, but certainly not least, Chek Kids, a great complement to the Canadian Tire Retail Canada's kids store strategy. We've acknowledged that kids and families are a big part of our one company -- our customer strategy, and now Sport Chek and CTR are teaming up to build even stronger relationships with Canadian families. Without going too far in terms of our plans, I think it's safe to say you should expect to see the consumer brands division also playing a role in this space most likely in kids' apparel and outerwear.

While all these is excellent progress, we still have work to do. We've mentioned our delivery to home trial will be in market later in this year or early '18. This is, obviously, a big project, an important step for Canadian Tire, as we work with dealers to evolve our customer experience. In recognition of the importance of our credit card business, we'll be continuing our collaboration with CTFS, and CTR will play an important role in the marketing and launch of Crimson next year. We've made progress in owned brands, and the launch of premier paint was a great next step for us in this very important category. Our productivity initiatives are not complete, and the teams continuing to drive operational improvements across the business, and as you know, we've been working hard to weather-proof CTR, wherever possible. But we had successes and our -- while we've successes, our weather businesses still grew quite well in 2016, meaning, we have to continue our efforts. These initiatives have all been created and executed by a leadership team that believes in the power of cooperation, amongst the banners and with our dealer partners. We're committed to a new vision of our customers, and are very optimistic about the next chapter of our evolution.

So I could go on all afternoon, but I'll stop here. Suffice to say, we have a lot going on, but we're incredibly excited about the opportunities ahead.

With that, I'll pass it over to Dean.

Dean Charles McCann - *Canadian Tire Corporation, Limited - CFO and EVP*

Thanks, Allan, and good afternoon, everyone. As Q1 is a very small retail quarter for us, I will keep my comments brief today and focus on a few key areas. Overall, it was a solid quarter for us, with diluted earnings per share of $1.24, up 37.8% over the first quarter of 2016. We generated strong top line results from our Retail segment. Much of the revenue growth can be attributed to the underlying strength in our CTR banner, as dealers bought in to us spring merchandising programs and replenished inventory coming off of a very strong Q4 2016 sales performance. I can't help saying in hindsight, they could probably have waited to buy spring assortments a little bit longer, given the late break to spring, but our stores are certainly ready for business once the seasonal weather shows up across the country.

The consolidated Retail segment margin, excluding Petroleum, was essentially flat, down 7 basis points. FX continue to be a negative influence on margin, and while it will continue to be -- somewhat of a headwind for us over the course of the year, our hedges had been maturing and that impact will begin to moderate somewhat year-over-year.

As we've mentioned over the last few quarters, there had a been a number of margin levers that the retail teams, particularly at CTR, has successfully used to offset negative FX impacts. Those really fall into 3 broad categories: pricing, which captures the use of science to set regular and promotional pricing; second is sourcing, which captures the cost of -- and composition of product input, as well as vendor selection using robust data analysis to support the negotiations. And third, product mix, which considers the composition of our assortments, understanding the relative share of private versus national brand product, and then as well as other factors such as freight cost and dealer margin sharing arrangements.

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And while we've discussed -- while we have, as discussed many times, been making headway and doing a much better job managing all these factors, there are a lot of moving parts. And while some inputs may begin to move in a positive direction, like FX, as we continue to a more comparable level of year-over-year FX cost, others, like commodity prices, for example, can move in the opposite direction. But the greatest benefit of our operational efficiency program is how the teams have embraced the new tools and gained access to data to make margin-related decisions for the retail businesses. It was a substantial improvement in our OpEx ratio, excluding depreciation and amortization and Petroleum this quarter, which was better by 91 basis points compared to the prior year. As you may recall, last year's OpEx included several one-time items that had impacted our performance such as higher-than-normal variable compensation and our support of ongoing operational initiatives. In addition, our strong revenue growth at CTR discussed earlier drove down the OpEx ratio in the quarter. Of course, I'm pleased with the trend, but this is a small quarter, and we are committed to investing in the initiatives that will drive long-term growth, like building expertise in product development and data analytics, which will occur over the course of the year. So rather than read too much into a single quarter metric, I continue to be focused on the same goal expressed in prior quarters of expanding EBITDA as a percentage of revenue over the course of the year.

The Financial Services business posted solid results with GAAR growth of 5.8% in the quarter, reflecting the investments made to drive new customer accounts and GAAR growth throughout the prior year. In addition, we are seeing the benefits in both our Retail and Financial Services businesses from the integration initiatives that we have been implementing.

Despite a slow start to the spring selling season, inventories are in healthy and clean -- are healthy and clean across all the retail businesses, with the extended colder weather across the country, resulting in good sell-through winter inventory, particularly in January and February across all the retail banners. Although FGL experienced slower sales in the quarter, inventory levels improved year-over-year due to adjustments the team made in terms of its buy coming into the winter season.

We continue to make progress on ROIC. It was 8.58% for the quarter, up 48 basis points over Q1 of last year, and up 24 basis points from Q4 of 2016. Strong Retail segment earnings and improved working capital investment were the primary drivers of the improvement.

As I said -- as I have said many times, this is our toughest aspiration to achieve, particularly in light of FX and Alberta pressures over the last couple of years, but the improvement in the quarter is encouraging. Our operating capital expenditures were approximately $68 million, reflecting a lower year-over-year spend on real estate and information technology projects. Our distribution capacity spending was also down year-over-year due to an unexpected lower-level of investment as construction of the Bolton DC is now complete and going through the process of coming online.

And with that, I'll turn the call back over to the operator for the Q&A session. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from Irene Nattel of RBC Capital Markets.

Irene Ora Nattel - *RBC Capital Markets, LLC, Research Division - MD of Global Equity Research*

I was wondering if we could please start with the discussion about CTFS. Obviously, there's a great deal going on right now within the whole Financial Services space. If you could walk us through how you see CTFS, how comfortable you are with your portfolio and the risk profile, as well as your sources of funding.

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Gregory George Craig - *Canadian Tire Corporation, Limited - CEO of Canadian Tire Bank, President of Canadian Tire Financial Services and President of Canadian Tire Bank*

It's Greg here. I'll start maybe with the risk profile, and maybe Dean can speak a bit more to the funding side of things. Very comfortable with the risk portfolio. If you think back to the actions we took a few years ago, given an uncertain economic condition out in Alberta, I think what you've seen, and also just other changes made to collection strategies and credit risk strategies for the past few years, you've really seen an improvement. Our aging rate was 50 basis points at the end of Q1, lower than where it was last year, and that was hit lower in every province across Canada, which is the first time we've seen that in a few quarters. The write-off rate improvements have also been strong, so from a credit risk perspective, really pleased with what we've seen over the past few years, and it started about 2 years ago, and it just -- we've just continued that journey.

Dean Charles McCann - *Canadian Tire Corporation, Limited - CFO and EVP*

And on funding side, Irene, we've always prided ourselves with operating very conservatively from a funding perspective with respect to CTFS, and quite frankly, with respect to CTC, in general. Our strategy includes having multiple sources of funding for CTFS, which covers the broker deposit channel, the securitization channel, [HIS] all of which is back-stopped and with our $2.25 billion line that we've put in place when we did our Scotia deal, and all of those sources of funding are lathered out. So we are very cognizant of ensuring that we don't have big chunks of funding coming to -- in any given year and we lathered out, typically out over kind of a 5-year period. So as I said, fundamental is operating very conservatively with respect to managing the balance sheet of the bank, and certainly, the corporation.

Irene Ora Nattel - *RBC Capital Markets, LLC, Research Division - MD of Global Equity Research*

And as far as the broker deposits go, Dean, have you seen any changes in the last few weeks?

Gregory George Craig - *Canadian Tire Corporation, Limited - CEO of Canadian Tire Bank, President of Canadian Tire Financial Services and President of Canadian Tire Bank*

No, no. It's Greg. No, there hasn't been a change in our ability to raise, and even at the rates, we've been able to attract new deposits hat. So no, there hasn't been any change in broker deposits nor has there been any change in our hind street savings volumes.

Irene Ora Nattel - *RBC Capital Markets, LLC, Research Division - MD of Global Equity Research*

That's great. And just one other question, if I might ask, would it be possible to expand a little bit more on the one company initiative, where you would like to see Canadian Tire, for example, 3 years versus today, and what steps you have to take to get from here to there and of course, how much is it going to cost?

Stephen G. Wetmore - *Canadian Tire Corporation, Limited - CEO, President and Non-Independent Director*

Irene, it's Stephen. Well, as far as we've made -- we've made some great progress to this point in time. I think the -- as I said, this morning, that we've built our brands to a point now where they are very strong. I think not having a system pretty much at all within Sport Chek's environment, FGL's environmental to capture customer data, which is changing somewhat with their point-of-sale system. And I think also being able to take our credit card across the banners, which we intend to do during -- much more during the early part of 2018, again, will be an exceptional way to capture more data across our organization. And then building, because we have all the data, like an enormous amount of data coming through Canadian Tire Retail and also through Canadian Tire Financial Services. So to build that the data pool, we -- thanks to Eugene and the team, now have a warehousing system that is actually accessible. We have built the tools to access our enterprise data warehouses. We trained our staff now to a great degree, which I also referenced this morning in terms of using data analytics to go along with some of the real core data analytics teams that already operate within our organization, including Financial Services. So I think the groundwork is there. And we've also already done a fair amount in terms of trying to look at one customer view in a lot of our data segmentation work that we're doing. So we've made excellent progress. I think over the next couple of years, it's going to be us experimenting, getting our data together, understanding the marketing efforts that have to go

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behind it from a digital marketing point of view and a ownership of the customer point of view. We restructured CTRs, so that we have kind of one person that is, in fact, in charge of the customer experience across the spectrum. We, as you know, through the years, have combined our back-offices, so that we actually are operating as one company from that aspect of it. And we are now sort of fully completing the combining of our supply chain and fulfillment operations under one view. Certainly, our own brand strategy is with one view, concentrating initially, obviously, to help Canadian Tire Retail, but that is moving quite rapidly. So I think we'll make very good progress, but it's going to be us being able to collect enough data, understanding our customers across the spectrum. That will really move the yardstick over the next 2 to 3 years.

Operator

The following question is from Peter Sklar of BMO Capital Markets.

Peter Sklar - *BMO Capital Markets Equity Research - Analyst*

Just one question on this data collection. When you collect data through your point-of-sale system and you're collecting other data through your credit card, are you able to figure out that it's the same customer? Or like are you able to merge the data for the same individual that you're getting from different sources?

Gregory George Craig - *Canadian Tire Corporation, Limited - CEO of Canadian Tire Bank, President of Canadian Tire Financial Services and President of Canadian Tire Bank*

Peter, it's Greg here. Yes, so with the introduction of our loyalty program, (inaudible) a few years ago, we have the ability to kind of link in that information to the credit card information to get kind of a more kind of holistic view of one customer. So yes, we have that ability if you're a (inaudible) customer with a credit card, we can link that information and get a view of your transactions across our banners.

Peter Sklar - *BMO Capital Markets Equity Research - Analyst*

So the key is they have to belong to your loyalty program?

Gregory George Craig - *Canadian Tire Corporation, Limited - CEO of Canadian Tire Bank, President of Canadian Tire Financial Services and President of Canadian Tire Bank*

Correct. If they don't belong to the loyalty program, I don't know who you are, right, so...

Peter Sklar - *BMO Capital Markets Equity Research - Analyst*

Okay. I had a question on the inventory position. You said that all banners are pretty clean in terms of your inventory positions. I would have thought though at the sell-through you had in terms of winter categories, I can see you're very clean, but with the late break for spring, I thought you might be a little bit chunky in terms of your spring categories. And so again, just comment on why you're in good shape in terms of spring categories?

Dean Charles McCann - *Canadian Tire Corporation, Limited - CFO and EVP*

Maybe I'll do it on an overall basis, Peter, and then let the operators kind of if they want to chip in. But from -- in terms of corporate inventory, obviously, my comments were that we came out the quarter exceptionally clean. So -- and I would highlight, FGL particularly came out clean despite being a little softer from a sales point of view. In terms of CTR in-store, the dealers are obviously prepared for the selling season. So they bought into, if you will, the programs that Allan and the team has put in place. You saw that in the fourth quarter, and are ready, obviously for spring to

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show up. So they're, as I say, very clean, because they're with inventory that is ready for the season with some exciting stuff to offer, and I would reiterate that for both Mark's and FGL, but I'll let the guys if they offer anything else up with respect to that.

Stephen G. Wetmore - *Canadian Tire Corporation, Limited - CEO, President and Non-Independent Director*

Yes, I mean, no, that's well said. I mean, we're feeling pretty comparable in terms of being ready for the winter -- for the spring, sorry.

Peter Sklar - *BMO Capital Markets Equity Research - Analyst*

Right, okay. And then my last question is Sport Chek seems to have lost its way a little bit in terms of sales momentum. It just doesn't put up the spectacular comps that it used to, and I'm just wondering what management thinks the issues are there and what steps you're taking to rejuvenate the momentum at Sport Chek?

Stephen G. Wetmore - *Canadian Tire Corporation, Limited - CEO, President and Non-Independent Director*

Yes, Duncan.

Duncan Stanley Allpress Fulton - *Canadian Tire Corporation, Limited - President of FGL Sports Ltd*

I think I'd have to disagree with the characterization. We feel very, very good about the business. Obviously, not about the top line performance in Q1. But every time that -- we exist to provide the things for the jobs and joys of Canadians. Stephen have said that a number of times. Our core categories operate extremely well. If you look at January, when it's plus 12 degrees, we had decisions to make in Q1 about whether we want to discount winter boots and discount winter jackets against warm weather. If you look at all the other core categories inside Sport Chek and if you take Q1 as an example, the rest of the top 10 categories were all up. Athletic was up. Hockey was up, accessories was up. License was up. Ski and snowboard were up, with the extended kind of winter that went through Q1, and what was down was winter jackets and winter boots. And as you got into March, compared to last year, when everyone was buying quite early kind of spring running gear and spring running shoes, it just didn't trigger as quickly. Undoubtedly, and we said this last quarter, the business have been built to serve those jobs and joy, as certain weather patterns trigger and times of the year trigger, those categories perform. So we need to do a better job of making the business less purely weather-dependent. There's always going to be a seasonal component to what we do. Some of the efforts you're going to see us make in kids, with woman, lifestyle categories that are more year-round categories, those are specifically designed to smooth out some of those valleys, which none of us like to see. But I have no doubt at all, and we've seen it consistently that, at those key times of year and at those key weather triggers, we are the leading market share in Canada in all of those categories that Sport Chek plays in, and people come to us consistently and we plead them consistently. So I'm not worried about where we're heading here.

Operator

The following question is from Mark Petrie of CIBC.

Mark Petrie - *CIBC World Markets Inc., Research Division - Research Analyst*

Actually, I just wonder if you could talk a little bit about your relationships on the manufacturing side, particularly, as you grow your own brands, how you're thinking about that capability and what's your view on being able to grow capacity as those brands become bigger and bigger?

Stephen G. Wetmore - *Canadian Tire Corporation, Limited - CEO, President and Non-Independent Director*

(inaudible) for CTR?

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Allan Angus MacDonald - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

Sure, yes. I'll talk it. Mark, It's Allan. In terms of manufacturing, I think probably a good indication from the Paderno deal, and I'm not sure if you've got a chance to see the details, but we've made an agreement with Meyer to operate the manufacturing facility. Our inclination is we want to grow and expand our capacity to source good products with really good design and innovation. So much more on the search and design part. Further sort of expanding from that in the manufacturing, I think, is outside of our bailiwick and not really what we want to turn the company into. So when it's a necessity to get the right brand and access the right technology or markets, and something that we're going to have to face. In the case of Meyer, we thought it was a really good opportunity with Paderno to take one of our partners, and the 3 of us kind of partnered together to let them do what they do best and let us manage the brand. So I wouldn't expect that you should see Canadian Tire looking to diversify further into manufacturing. If anything, it's really outside of what we're focused on.

Mark Petrie - *CIBC World Markets Inc., Research Division - Research Analyst*

Sure, no, I appreciate that. I guess, maybe just more specifically, like on something like NOMA, where it's been a big success for you guys, but probably just given the penetration, limited ability to grow that within CTR, how do you think about growth for a brand like that over the next few years?

Stephen G. Wetmore - *Canadian Tire Corporation, Limited - CEO, President and Non-Independent Director*

In terms of the brand independently, you mean?

Mark Petrie - *CIBC World Markets Inc., Research Division - Research Analyst*

Right.

Stephen G. Wetmore - *Canadian Tire Corporation, Limited - CEO, President and Non-Independent Director*

Well, I mean, for us, there's a couple things that are on a table. One is obviously growth outside of Canada. Not the type of brand that we typically look at growing inside of Canada and other retailers, so there's an expansion of the wholesale market, which is an opportunity, and the other is expanding the brands into adjacent categories. So if you think about where NOMA could travel after lights, it would work very well in the home lighting category, perhaps, the home air filtration category. And as we continue to build the family of products for NOMA, you add on top of that new product innovation. So last year's version of Christmas or outside decor that was NOMA branded is going to look different in the years to come. So between geographic expansion to different markets, broadening of the branded and new categories and some pretty deep and involve product innovation, I see a lot of opportunity for those brands.

Mark Petrie - *CIBC World Markets Inc., Research Division - Research Analyst*

Okay. And then I guess, shifting gears a little bit, you talked about the home delivery test happening for CTR later this year or early next year and appreciating that it's a long way off. Would be interested to hear a little bit more, just in terms of how that will work, fulfillment from stores or how that will look and then how that cost arrangement will work with the dealers.

Allan Angus MacDonald - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

Well, it's early days for us right now, and as you can appreciate, this is a very complex trial because we're dealing with a hundred different categories and geographies that range from Metro Toronto to Northern communities. So while it's very much in the planning stages, we're not quite there. We know what we want to do, but I'd suggest it's probably worthy of an update in one of our upcoming calls to give you a little bit more details in

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terms of how we're going to start to position it in terms of when we'll roll it out, and deliver from node versus deliver from store and how we're going to handle that. So what I'd suggest is we'll get you up to speed, but today's probably not the best day to do it.

Operator

The following question is from Jim Durran of Barclays.

James Durran - *Barclays PLC, Research Division - MD, Head of Canadian Equity Research, and Senior Analyst*

I guess, my first question is probably toward Allan. So Allan, last quarter, I guess, you were mildly disappointed that strong winter weather showed up in December and took away the opportunity to show how well the business could do without the winter assist. So I'm interested in hearing your thoughts about what's different this quarter where, obviously, we didn't get conducive weather and the comp came in much weaker than the previous quarter, but weaker on a sort of 2-year stack basis as well, that stuff. How did the non-weather-related stuff do at CT retail?

Allan Angus MacDonald - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

Well, Jimmy, I'm not supposed to remember what I said in the previous quarterly call.

James Durran - *Barclays PLC, Research Division - MD, Head of Canadian Equity Research, and Senior Analyst*

Yes, I know that. That's impossible to do.

Allan Angus MacDonald - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

No, you know what? It's funny, we were talking about this not too long ago actually, and part of it is the dynamics of the different quarters. So Q1 is versus Q4. Q4 offers some very good non-weather-related opportunities, and it's a very big quarter. Q1, very much less so. When you take out the weather-related categories, other than Valentine's Day, there really isn't a lot that you can do there, and unfortunately, the hangover from Christmas in January, February, means that a great week in January is a good day in March. So it's really hard to insulate yourself against the weather in Q1. There's just fewer opportunities, so that's kind of part A. The other part has been the success we've had over the last of couple of years at Canadian Tire Retail in terms of raising our game in non-weather-related categories, has been one of those tides that lifts all ships. So along with that, our weather-related categories have also grown, not at the pace of the non-weather, but they've created year-over-year challenges for us because we're now comping even more success in weather-related categories. So we have some more work to do. The timing of March is, in my mind, really problematic, so we're going to sneak...

James Durran - *Barclays PLC, Research Division - MD, Head of Canadian Equity Research, and Senior Analyst*

A bit of of March.

Allan Angus MacDonald - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

Yes, well, if we could just have a quarter that starts in March and ended in June, it'd be easier. But -- so it just -- it really boils down to we've capitalized on the big opportunities first. Of course, Christmas is probably the shining star in that, and we just have to get our way down to the micro season. So we've got a lot of work to do there.

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James Durran - *Barclays PLC, Research Division - MD, Head of Canadian Equity Research, and Senior Analyst*

And I don't know if you can comment on this, but as we're now in the second quarter, historically, how does spring behave, like I'm assuming that bad weather just defers pent-up demand. But depending upon when we do miraculously get warmer weather, do we end up sacrificing some margin as we race to the finish line of the short spring season?

Allan Angus MacDonald - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

Well, all -- I can offer you this thought of CTR, I hate the weather now. It's certainly not helpful, but I've noticed in the past 4 Q2s is that demand does pent up, unlike some other seasons, so we remain optimistic. And in terms of margin, we're going to have to wait and see.

James Durran - *Barclays PLC, Research Division - MD, Head of Canadian Equity Research, and Senior Analyst*

Yes, okay, last question, just SG&A. So sure, there was the 91 basis point improvement, but as Dean pointed out, strong revenue growth in a small quarter gives you big bang on the SG&A line. Do we think that the 2.5%, 2.8% increase in SG&A year-over-year is a sustainable run rate for the rest of this year? Or are there dynamics that are going to change as we move through in things like DC start-up cost, et cetera?

Dean Charles McCann - *Canadian Tire Corporation, Limited - CFO and EVP*

Jim, maybe I'll offer a couple of comments there. We've telegraphed before that we will, in the third quarter, have some start-up related to DC, and probably, a bit of that in the second quarter, but we'll have the depreciation kick in as the DC comes online as an example. So that's one kind of, if you will, notable factor, and we'll highlight that for you when we get out. In terms of the OpEx ratio and the absolute dollars year-over-year, as I've said in my comments, and certainly, which we reiterated in the kinds of things that Allan and Stephen talked about, there is -- there are investments that we want to be making for the long term, as we look at the business with the comps around data analytics and the brand development strategies that the team is doing. We want to do more and more of that, so we're not going to curtail investment in the business. That said, and I'll just go back to the standard pattern with respect to what we're trying to achieve here, which is drive up our EBITDA percentage as a percentage of revenue over the course of the year, and that's what we want to do in a sustainable way. I will tell you that what we experienced in the first quarter is encouraging, but again, just remind everybody not to get overly excited about our smallest quarter relative to a very strong numerator.

Operator

The following question is from Derek Dley of Canaccord Genuity.

Derek Dley - *Canaccord Genuity Limited, Research Division - MD and Consumer Products Analyst*

Just wondering if you could quantify the FX headwind in terms of basis points on the margin this quarter?

Dean Charles McCann - *Canadian Tire Corporation, Limited - CFO and EVP*

No, Derek, we don't typically do that. Well, we've never done that, to be honest. So what I would say is the delta year-over-year, the glide path is coming in for a bit of a landing. We'll still have negative headwinds as we go through the balance of the year, but the order of magnitude is quite a bit less, so I'd say kind of 1/3 of the impact that we've experienced, and kind of effective rate to effective rate, and so that will give you a sense. That said, I'd remind you that nothing happens in isolation. So that's why I made some comments about kind of all the various drivers, and the teams have done a really good job of managing all those. But commodity prices, those kinds of things can go the wrong way as well, right, and when market forces kind of come into play. So they're all factors, but just pure FX, yes, we'll see on in year-over-year basis less of an impact as we're going through the balance of the year, but there'll be some other forces that play too.

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Derek Dley - *Canaccord Genuity Limited, Research Division - MD and Consumer Products Analyst*

Okay. No, that's fair. And then just switching to CTFS, you guys have some strong GAR growth this quarter, along with a still slightly elevated investment in driving that GAR. Should we expect sort of a similar cadence over the balance of the year or are those investments starting to wind down a little bit?

Stephen G. Wetmore - *Canadian Tire Corporation, Limited - CEO, President and Non-Independent Director*

It's -- I think we've said before, we've made a lot of progress in the last year with CTR around integration, and that really has helped drive that receivable number to where it was for the quarter. We think there's still a lots of runway in CTR to grow this out even further, and then extend that into the other banners, like a Mark's and an FGL. So Mark's, for example, we just started testing in-store acquisition in the fourth quarter, and we're looking to -- actually, just started testing it, a few stores in Sport Chek as well. So I think we'll continue that journey because we think there's lots of runway left to still continue to grow this business.

Operator

The following question is from Brian Morrison of TD Securities.

Brian Morrison - *TD Securities Equity Research - Research Analyst*

I'm wondering if you can just circle back to the private label commentary. It appears the owned brands, they're increasingly important from a strategic standpoint. It sounds like product mix appears to be mentioned each quarter in your margin performance now. So I'm wondering if you're able to discuss the penetration levels, perhaps, by banner. I presume it's highest at Mark's. I wonder if you can confirm, it sounds like it's very or fairly early days with respect to the opportunity for maybe portfolio expansion relative to where you currently are. And maybe just from a high-level, how meaningful an impact this has upon your results, as presumably, it's much higher margin business?

Stephen G. Wetmore - *Canadian Tire Corporation, Limited - CEO, President and Non-Independent Director*

Taking it?

Allan Angus MacDonald - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

Well, okay,

Stephen G. Wetmore - *Canadian Tire Corporation, Limited - CEO, President and Non-Independent Director*

Just CTR, and then we'll just move on.

Allan Angus MacDonald - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

Yes. Yes, when it comes to CTR, we're looking at continuing to expand. And when we think about the penetration of the private brands, it's really important to anchor in why we're doing it, and it's about connecting with our customers, looking for ways to introduce new innovations, and grow our relationship with Canadians. So we're doing it in strategic categories. So our private brand penetration, overall, is not nearly as important as it is categorically. So as I was saying earlier in kitchen, that's a category where brand is very, very important. It's a brand-driven category. It's one where we only had 8% penetration in private brand, and we want to be able to have our -- maintain our unique assortment and our unique value

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proposition for Canadians. So we knew getting a good, better or best leveled brand that had national recognition in kitchen was going to be incredibly important for us, so I made the Paderno move. So we're going to continue to look at, first of all, introducing brands in areas where we know it's going to be important and where there's opportunity because we're under-penetrated and then growing them as healthily as we can. That doesn't necessarily mean that we're shifting demand from national brands to owned brands. In the case of the introduction of woods and camping, we saw woods delivered tremendous growth and accretion at the margin level, but the national brands grew at the same time. So we're not looking to get incremental margin simply by a shift. We're looking to introduce new brands and strengthen the category, making an incremental contribution because they should be more profitable because of the direct nature of the brands, but are much more strategic in terms of our position with our customers. And then layer on top of that, that will be one of the primary mechanism through which we introduce innovation and sort of exciting new products for our customers. So again, I wouldn't look at it more categorical, look at in terms of each individual -- or sorry, overall in terms of each individual category.

Brian Morrison - *TD Securities Equity Research - Research Analyst*

What's an adequate penetration rate of some of your key categories? You say 8% is underpenetrated. What would be some of the higher penetration rates in key categories?

Allan Angus MacDonald - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

That's a great question. I mean, we're about 1/3 overall, and there's lots of noise in that. There's categories that are all private brand and some of them are none. But Christmas would be at the high end, north of 80%. And kitchen, quite frankly, for a brand-driven category was at the very low end, which is one of the reasons why I made a big priority to get on it right away. So I don't think that -- I would be shooting more for the average sort of your 30%, I think, is a really good place to be. But again, it's category specific.

Brian Morrison - *TD Securities Equity Research - Research Analyst*

And is there opportunity within Mark's for further expansion of private label or are you sort of at a ceiling in that business now?

Richard J. White - *Canadian Tire Corporation, Limited - President of Mark's Work Wearhouse Ltd*

Yes, it's Rick here. I think, really, what it is at Mark's, it's a question of balance right now. There is opportunity to grow our private label in certain categories, and in other categories, we're actually, believe it or not, growing our national brand. I'll give you an example of that, in footwear, the national brands are growing. Our overall footwear business is growing, especially in the casual area, but we're experiencing greater growth in national brands because that's what the consumers are looking for. We have another category, such as industrial. We're growing our private label business. So it's really category specific, and it's about balance. So we're tweaking each of the respective categories, where we feel that it best meets the consumers needs, and so it's really about segmentation, and it's about giving us the ability in the private label area to introduce new technology and to drive innovation to make that point of difference for us and to set us apart from our competition, whether it be online or in-store.

Brian Morrison - *TD Securities Equity Research - Research Analyst*

And sorry, just on FGL, is there any opportunity there or is it just too dominated by national brands?

Richard J. White - *Canadian Tire Corporation, Limited - President of Mark's Work Wearhouse Ltd*

I think there's actually tremendous opportunity at FGL. We have a very -- today, we have a very low mix of private label owned brands inside of the FGL family because we are a leading destination for Canadians and all things active living. When you look at an outdoor category, an athletic category, kids category, lifestyle, the ability to introduce wholly-owned labels create some brand here around those, differentiate products. Mark's

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had done an exceptionally job at building brand love for products that are highly differentiated from other things you can find in the market. I think there's an opportunity to do the same thing at FGL. So I think there's even more opportunity with us to see more.

Operator

The following question is from Keith Howlett of Desjardins Securities.

Keith Howlett - *Desjardins Securities Inc., Research Division - Consumer Products & Merchandising analyst*

Just going back to FGL Sports. I think when you bought Forzani's, they had a lot of private brands, McKinley, Firefly, all sorts of -- I think they were bought through their international sourcing. And I think, if I'm not mistaken, the store has shifted more to national brands. So I'm just wondering, is that because you didn't have that much confidence in the differentiation of the ones that you inherited or just sort of how you're thinking about that?

Richard J. White - *Canadian Tire Corporation, Limited - President of Mark's Work Wearhouse Ltd*

I think that -- I don't think there's been a shift since the acquisition, and you've seen McKinley, Diadora, Firefly, [MacNamera] and the stores. Admittedly, we've never put a major brand focus behind those brands. Typically, when you see advertising from Sport Chek, we're advertising our top vendor partners, who are great partners to us, and the customers want those brands, as they create brand heat in Canada and around the world. Frankly, Sport Chek's never even tried to create brand heat around. Those kind of brands will be either licensed or owned, and I think with more of a focus on this. Now understanding exactly where we want to differentiate, and whether you're differentiating on a product attribute or a price, which category you want to do it in kids or outdoor or lifestyle, and deciding which brands you want to get behind, I think there's nothing but opportunity there. But I would say, there's been no shift away from it. There just hasn't been a -- there hasn't been the same focus on it than you've seen at CTR and Mark's over the years.

Keith Howlett - *Desjardins Securities Inc., Research Division - Consumer Products & Merchandising analyst*

And then on the move to one company, I'm just -- in terms of store formats, are there any formats that aren't going to be part of the one company, one customer? I'm just wondering what the future atmosphere or the small market Canadian Tire stores or part stores or is everybody part of the go forward?

Stephen G. Wetmore - *Canadian Tire Corporation, Limited - CEO, President and Non-Independent Director*

Yes, Keith, we never -- we haven't -- we didn't kind of do it with that concept in mind, if you will. If -- wouldn't surprise me through the years that something like that actually perhaps occurred, but it's not part of the one company strategy, per se.

Keith Howlett - *Desjardins Securities Inc., Research Division - Consumer Products & Merchandising analyst*

And then if I might, because I'm not sure Patricia's on the line, can you speak about basket versus traffic?

Stephen G. Wetmore - *Canadian Tire Corporation, Limited - CEO, President and Non-Independent Director*

CTR-specific or what?

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Keith Howlett - *Desjardins Securities Inc., Research Division - Consumer Products & Merchandising analyst*

No, I was wondering across the 3 major groupings here.

Stephen G. Wetmore - *Canadian Tire Corporation, Limited - CEO, President and Non-Independent Director*

We don't...

Gregory George Craig - *Canadian Tire Corporation, Limited - CEO of Canadian Tire Bank, President of Canadian Tire Financial Services and President of Canadian Tire Bank*

Keith, we don't -- as you know, we don't do traffic and basket and separate those out. So for us, sales are sales. So we haven't historically hide that stuff out, so...

Operator

Thank you. This will conclude today's call. A webcast of the conference call will be archived on Canadian Tire Corporation Limited Investor Relations website for 12 months. Please contact Lisa Greatrix or any member of the IR team if there are follow-up questions regarding today's call or the materials provided. You may now disconnect.

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