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CTC.A.TO - Q4 2019 Canadian Tire Corporation Ltd Earnings Call

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CORPORATE PARTICIPANTS

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

Dean Charles McCann *Canadian Tire Corporation, Limited - Executive VP & CFO*

Gregory Huber Hicks *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

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

CONFERENCE CALL PARTICIPANTS

Brian Morrison *TD Securities Equity Research - Research Analyst*

Christopher Li *Desjardins Securities Inc., Research Division - Research Analyst*

Derek Dley *Canaccord Genuity Corp., Research Division - MD & Consumer Products Analyst*

Irene Ora Nattel *RBC Capital Markets, Research Division - MD of Global Equity Research & Senior Equity Analyst*

Mark Robert Petrie *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

Patricia A. Baker *Scotiabank Global Banking and Markets, Research Division - Analyst*

Peter Sklar *BMO Capital Markets Equity Research - Analyst*

Vishal Shreedhar *National Bank Financial, Inc., Research Division - Analyst*

PRESENTATION

Operator

Good morning. My name is Laurie, and I will be your conference operator today. At this time, I would like to welcome everyone to the Canadian Tire Corporation, Limited Fourth Quarter and 2019 Year-end Results Conference Call.

(Operator Instructions) This morning, Canadian Tire Corporation, Limited released their financial results for the fourth quarter of 2019 as well as the full year. 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 & Non-Independent Director*

Thank you, operator. And good morning, everyone, and thank you for joining us. Allan and Dean are with me this morning as well, and they'll comment in more detail on the quarter. So I'll keep my comments more towards the full year and some of our key initiatives.

As all of you who cover our business recall, we had a number of issues that affected our results in the first half of 2019, which created quite a challenge as we looked ahead to our final 2 quarters. However, our organization has responded extremely well across all our businesses with consolidated comparable sales for the year at 3.6%, which has exceeded our published aspirations of 3%.

CTR's top line growth was a highlight with comparable sales of 3.8% on the year and 4.8% in the quarter, exceptional performance from our core CTR business.

Our earnings per share performance is also in line with our aspirations and reflects the strong contribution of our Financial Services business, which continued to execute exceptionally well in 2019. Our 2-year average EPS growth is 10.6%.

And looking at our ROIC performance, our return on invested capital, I'm pleased at where we are, the initiatives we have announced to further our financial performance. A 10%-plus ROIC is the number we should, and are striving to achieve to match our strong top line performance.

That's a good segue actually into the status of our Operational Efficiency program, which is well underway under Greg Hicks' leadership, and we are tracking to plan. Top-down and bottom-up analysis of our complete organization has been completed. Initiatives assigned and coordinated and actions being taken. It's actually an exciting journey we are laying out for all of us as we embrace a truly different way of working.

2019 also allowed us to increase our dividends for the 11th consecutive time with a current payout ratio of 34%. We continued our share buyback program and most importantly, continued investing in our business through our extensive capital projects for the years ahead.

CT REIT has also performed well. We're very pleased with the investments they are making and the strong, consistent profitability they are generating. We recently adjusted our ownership, and we now stand at 69.4%. The REIT is now included in the S&P Composite Index, the Capped REIT Index and the Dividend Aristocrats Index, reflecting the increase in its liquidity and their track record of distribution increases.

In terms of Helly Hansen, total revenue in 2019 was $650 million. And while almost 80% of that was generated internationally, our Canadian business is growing very well and in line with our expectations. Allan will talk to you in a moment about the strong customer response to the brand across our Canadian banners.

Helly Hansen's leadership team is also making important progress developing key market opportunities through improved brand awareness in the U.S. and new European markets and has executed as planned on marketing investments to further build the brand, which also saw a 6-point improvement to its already impressive NPS score in 2019. There is significant growth potential for the brand globally, and we will update you on our progress during the course of the coming year.

Looking forward to 2020. We will continue to execute against our strategic agenda with focus on digital, stores and product, the fundamentals of our business. And we are executing our critical Operational Efficiency program, building marketplace capabilities, strengthening owned brands, growing international and growing our Canadian Tire credit card offerings. These initiatives are the key drivers of our growth and we have invested in the talent and funding to drive them forward. Again, Allan will speak more to the customer engagement initiatives shortly.

Our brand, culture and talent are our most important assets. And I'm proud to say that in 2019, Canadian Tire Corporation was recognized with an abundance of awards, including ranking first in Léger Marketing's annual survey of Companies Canadians Admire Most; recognition by Brand Finance as the strongest retail brand in Canada; and again, being named a top employer for young people.

Our commitment to the community and building a sustainable organization were also recognized as we were named one of the Global 100 Most Sustainable Corporations in the World by Corporate Knights and listed on the DJSI World, part of the Dow Jones Sustainability Indices, which represents the top 10% of global companies.

Now a year ago, I shared the news that our CFO, Dean McCann, would be retiring from his role. And last month, we were extremely pleased to announce the appointment of Greg Craig as Dean's successor. While Dean is a hard act to follow, Greg's career with Canadian Tire positions him perfectly to transition to -- into a role that I know he will excel in. And Mahes Wickramasinghe's diverse experience in finance and banking and his deep understanding of our retail business are great assets as he assumes his new role as President and CEO of our bank, along with his continued role as Chairman of Helly Hansen.

So with that, I'll hand the call over to Mr. MacDonald.

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

Thanks, Stephen. Good morning, everyone. It's a pleasure to be here with you when we have such -- we ended the quarter on such a positive note. While our numbers speak for themselves, we also saw continued growth in our key measures of customer engagement.

In Q4, we had record participation in our Triangle Rewards program. We had $2.4 billion of sales through our loyalty program, up over $200 million versus last year. Active customers were up 5% with average spending increasing a further 6% in the quarter.

On our last call, we spoke about the value of growing the number of loyalty customers who shop more than one of our banners. And in Q4, nearly 3 million loyalty members shopped more than one banner. That's up materially from last year. Our loyalty program has become an important contributor to our performance, and the growth we're seeing bodes very well for the future.

Customers also visited us more frequently in store and online. In stores, we saw increased engagement across the network from small communities to large urban centers. This was especially true with CTR, demonstrating the power of our dealers to serve customers in their local markets.

Now over the past few years, we've committed to building a compelling digital experience and a competitive omnichannel marketplace for Canadians. In Q4, we saw our customers respond very positively. We achieved our annual goal of exceeding 0.5 billion web visits. And our work to improve the CTR app is paying off with active customers growing 16% versus last year.

Last quarter, we shared with you that our previous 12 months of e-commerce sales were in excess of $500 million. And throughout the fourth quarter, this trend continued, thanks to strong digital traffic, conversion and the success of Cyber Monday, our biggest online sales day in the company's history.

We've also continued to stress that our own brands investments are part of a strategy to have the most curated assortment for the jobs and joys of a lifetime in Canada. In Q4, our own brand performance was up across all banners and accounted for almost 40% of our sales. Our top 10 brands, including MotoMaster, Denver Hayes, Wind River, Mastercraft and Canvas delivered a combined growth of 9%. Helly Hansen has also been outstanding, ramping up fast, with sales doubling at Sport Chek year-over-year and nearly the same as Mark's.

Now a few words on our banners' results for the quarter. I'd like to call out CTR's exceptional 5% retail sales growth in Q4 and 4% for the year. While there were some prominent growth areas, sales were strong across our categories, which is an incredible achievement. And not surprisingly, CTR saw meaningful gains in its market share in the quarter.

Sport Chek's performance was above our expectations with a full year comparable sales growth of 3.3% and Q4 growth of 2% for all of its banners. The Sport Chek banner specifically achieved a strong 3.8% comp, holding share in a highly competitive market. These results are very encouraging and prove the repositioning that's been underway at Chek is having an impact as the business continues to grow. Mark's full year comp of 2.5% and 1.8% in the quarter was on par with our expectations. Growth was driven by the strength of our hero categories despite another unseasonably mild December.

Now since we're in Q1, I thought it would be beneficial to note some of the priorities we've identified for 2020. We've outlined for you our One Company, One Customer model, which is at the core of our strategy in Canada. In this model, strong retail banners, successful owned brands and a connected financial services and loyalty offering come together to deliver a world-class customer experience. We've begun to refer to these assets as our Canadian Tire Marketplace.

Our focus for 2020 is to continue to build these assets, bringing Canadians the very best products and brands for the jobs and joys of a lifetime in Canada, delivered through compelling digital and in-store experiences. We will continue to develop our assortments and brands throughout the year, which means integrating Party City and investing in growing Helly Hansen.

Our transformation work at Sport Chek will continue and will evolve to include Mark's, focused on new assortments, merchandising, e-commerce and digital connections.

Triangle Rewards will be our platform to engage customers across the marketplace, delivering unique and interesting experiences to drive greater share of wallet. Triangle's success also provides an incredible source of data, which will guide decision-making across the enterprise as we integrate our AI and data analytics capabilities to new parts of the organization.

Now many of these priorities will be enabled through our Operational Efficiency program. In addition to taking costs out of the business, initiatives within the program are transformational and will change the way we work across the company. Our Operational Efficiency program has over 200 initiatives, creating new capabilities and ways of working, from how we use analytics to curate assortments, to adopting new ways of collaborating to reduce our impact on the environment. It's an exciting time to be part of Canadian Tire as we look forward to 2020 as another year of transformation.

Now looking ahead to Q1. After 23 quarters of consecutive growth at CTR, the team is driving to extend that streak. I know Q1 is a small quarter but they're up against a 7% comp from last year, so the challenge is on.

Now finally, here at Canadian Tire, we have an expression: that there's no such thing as an unassisted goal. This, of course, means a person or company's achievements are thanks to many unsung heroes. Well, in my mind, that sums up Dean McCann's contribution to Canadian Tire. Dean, you've worked tirelessly to make each and every one of us successful in our own right, and you've helped to make this the best company in Canada to work for. Thank you, and congratulations, my friend. You will be missed. Over to you.

Dean Charles McCann - *Canadian Tire Corporation, Limited - Executive VP & CFO*

Thank you, Allan. I have to say something nice about you now. Anyway. I don't know if you guys have ever noticed that when the quarter is a little short of expectations, I have to do a lot of explaining, but when it's really good, Stephen and Allan are more than willing to talk about it.

But anyway, a few things. Before I get into the quarter, I did want to make a few general comments about the financial strength of the company as we head into 2020. As you know, this company enjoys one of the highest credit ratings of any retailer in North America. We have earned that by carefully managing our balance sheet, our debt maturities and our multiple sources of liquidity. Operating a company with 3 distinct capital structures of REIT, Financial Services and Retail, each independently and very conservatively positioned, is something we've done for many years.

We have, in fact, used that strength to acquire assets like Helly Hansen, along with a growing own brand suite that will generate long-term value and we are right on schedule with respect to our deleveraging plan post the Helly acquisition to preserve our very strong investment-grade status.

Now let me turn to the quarter and make a few comments. As a reminder, we normalized our results for Q4 '19, the costs associated with the OE program; some $6.5 million for severance, store closure and program-related expenses; and $2.4 million associated with the acquisition of Party City. And in Q4 '18, we normalized for the $50 million fair value adjustment related to Scotiabank's 20% interest in CTFS. So on a normalized basis, our diluted earnings per share were $5.53, up 15.7% from last year. And our full year EPS on a normalized basis was an increase of 9.1% versus the prior year.

As for the drivers of this performance, a few things to note, starting with our retail business. Retail revenue, excluding Petroleum, increased 5.1% in the quarter and 4.8% for the full year. CTR was a driver of revenue growth in the quarter. As stated at the end of Q1, our stores came out of the winter season very clean in inventory, which we knew would drive dealer shipments once seasonal revenue arrived in Q4, which it did, for at least a good portion of the quarter. And despite weather being a mixed bag in the fourth quarter, strong sell-through at CTR meant it ended the year leaner in inventory, actually down compared to 2018.

The entire retail team also managed margins very well, with retail segment gross margin, excluding petroleum, coming in up 30 basis points in the quarter. On a full year basis, normalized retail segment IBT was down a couple of points year-over-year. And while we are extremely encouraged by our top line growth and the stability of our pure margin performance, our earnings were impacted by the dealer margin sharing true-ups in the first half of the year that we've talked about and the nonoperational foreign exchange losses at Helly Hansen which we talked to you about in our last call.

And although those transient nonoperational impacts caused some volatility in our quarterly retail earnings, the fundamentals of our core retail business remains strong and our runway for future growth unobstructed.

Improvement in our OpEx ratio continued this quarter. Excluding IFRS 16 and normalized -- our normalized OpEx, ex-petroleum and depreciation and amortization on a consolidated basis, improved both in the quarter and the full year by 20 basis points and 60 basis points, respectively. With our big lift on foundational capabilities largely complete and spending having plateaued, combined with the OE program driving toward our $200 million target, we are starting to realize improved OpEx and EBITDA margin ratios.

And finally, a note on our inventory position at retail which is up year-over-year due to the planned increases at Sport Chek to position them to better meet customer demand, at Helly Hansen to create safety stock to handle increased demand and the addition of Party City.

Helly Hansen's revenue growth for the quarter was very strong, driven by the one-time impact of establishing a broader assortment, particularly at Sport Chek as well as the support of the initial sell-through of Helly Hansen at Sport Chek and Mark's. Adjusted EBITDA in the quarter performed as expected, reflecting strong revenue growth and planned investments in marketing.

Financial Services was a star in the year from an earnings perspective, delivering an exceptional 19% IBT growth in the quarter and 5% on the year driven by continued GAAR growth and improved earnings growth as our portfolio matures.

I would point out that as we head into 2020, as Greg has mentioned in previous quarters, we expect that the rate of GAAR growth is likely to move towards industry growth levels and the return on receivables on the portfolio to stabilize at around the current levels as the larger percentage of new accounts in the portfolio mature and season. And the early write-off experience, normal for these new accounts, rinses through the portfolio.

Our write-off in allowance rates have come in as planned, and we continue to see no signs of deterioration in the portfolio as our new vintages of accounts continue to track very closely from a credit performance point of view to historical norms. So for 2020, we have taken the view that the economy in terms of growth and employment and consumer spending will continue to perform similarly to last year.

Briefly, on capital spend. Our operating CapEx for 2019 was $444 million, which is in line with our expectations and at the lower end of guidance as timing of some projects shifted into 2020. For 2020, as noted last quarter, we expect to spend $450 million to $500 million on investments across our core assets, including rolling out CTR's new store concepts, foundational investments in our CTC marketplace as well as capital investments to support our OE program.

There are a couple of fairly straightforward things to keep in mind in modeling for the banners for 2020. First is, I think it will be a much less noisy year than last year, meaning, I don't think there are any big IFRS accounting change for us all to have to deal with.

You're welcome, Greg.

Our annual tax rate is estimated to be 26% over the course of the year. And as you know, ownership in the REIT is now sitting at 69.4%. And our EPS was negatively impacted by the increase in NCI related to the REIT to the tune of about $0.08 this quarter, and we anticipate a $0.04 impact per quarter through to Q3 2020.

2020 is also a 53-week calendar year and you should expect quarterly earnings changes as the Operational Efficiency initiatives are executed and earnings are normalized for those one-time impacts. But as I said, thankfully, no big IFRS changes to deal with.

And before I turn things over to the operator, I do want to thank Allan for his kind comments. But I wanted to say that it's been an honor and a privilege to have this role in this great company. I'm very pleased to be passing the reins to Greg Craig, and I know you will be in safe hands going forward.

And with that, I'll turn it over to the operator for the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from Patricia Baker from Scotiabank.

Patricia A. Baker - *Scotiabank Global Banking and Markets, Research Division - Analyst*

So in Q4, we saw some welcome improvement in OpEx in the quarter. And both Stephen and Allan did give some discussion of the Operational Efficiency program. But I wonder if Greg Hicks is in the room, if you can share with us, since you are in charge of that program, where you've seen the achievements anywhere in 2019, what we saw maybe in Q4, what we can look for specifically in 2020? And then lastly, at what point do you think that the costs associated with operational efficiency will start to roll off?

Gregory Huber Hicks - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

So I am in the room, Patricia. A lot of stuff there to absorb. Let me -- maybe I'll start with some context first and then give you a sense of how the programs unfolded and then maybe give you some illustrations of some of the things that we're working on from an action standpoint.

So contextually, as we've discussed since launching our One Company, One Customer strategy, we've invested quite significantly in customer-facing areas in an effort to drive our long-term competitive position. And when we made the announcement last year, the timing just felt right for us to look at our overall efficiently -- efficiency.

So here's what I can tell you now that I'm a few months in. We started with some pretty extensive benchmarking, I think we've talked to you about that, virtually every function in the company. And although we're a fairly tough retailer to benchmark, we've got a pretty good idea of where we're out of whack. So we took this work as the driving force behind a very intense, 10- to 12-week process that happened in the quarter. That was bottom-up and extended our reach well into the leadership of the organization. And we're in a position now, as Stephen said, where we've just laid it all out. Existing initiatives that were already underway, new initiatives, the team, the timing, preliminary views to the investments required and how they might impact the income statement, the balance sheet, everything.

And the great news from our standpoint is that the amalgamation of the bottom-up is really a redesign of how we work as an organization. And as we discussed on the last call, we really believe that this needs to be our intended outcome. And I can tell you if we deliver what's been identified in the current road map that we'll position ourselves not only to be more efficient, but to be more competitive going forward.

We've got lots of work to do on the initiatives, especially in terms of how they layer into our financial planning, the pacing, the capital, the one-time cost, et cetera. Dean always likes to keep this stuff close to his vest, so we'll see what we can do with the other Greg here and try to get you a little bit more color on these on our next call.

Yes. And maybe some examples of initiatives. I understand from the pre-calls this morning, everybody's looking for a little bit more granularity. So last call, we talked about focus areas in the program. So why don't I use these to give you a little bit more color with some initiatives?

The first thing that we talked about was eliminating duplicative systems and processes across our multiple banners as we truly begin operating as one company. We've got quite a few large initiatives in this area. We've got complex initiatives that are definitely going to take some time, things like consolidating all of our digital website platforms onto one common digital platform across all the banners or our implementation of a company-wide transportation management system. But we also have a lot of less complex activity here too like the consolidation of our many customer e-mail service providers across banners in our marketing group and the in-sourcing of our digital marketing capabilities across all of our banners. So we've talked about this focus area being about doing activities once, consolidating systems and processes and sharing best practices across banners and functions.

The second theme was really about the decommissioning of legacy infrastructure and process as a focus area. Here, we have initiatives like the consolidation of sources of data across the enterprise into a data lake and a mark for the organization, supported by the right cloud-based data systems; investing in new database processes for things like dynamic scheduling for our corporate-owned stores; implementing a new procure-to-pay system and process across the company that will change very old legacy processes for how we do things like managing contract labor requirements and non-merch procurement, which is a huge book of business across all of our banners.

And last, the third theme we talked about, targeting improvements for both our internal and external spend. And here, we've got a number of initiatives on the go, Patricia, mostly front-end loaded that target reduction in a number of spend areas. Think about things like inbound transportation, to call center services, distribution center automations, procurement initiatives. This focus area is really about what we spend our money on and the organizational effort required to ensuring it's productive or it links, at least, to our strategy.

Looking at our store assets, I think, is a great example. We see our store assets as needing to deliver not only financially, but also to drive appeal to our membership. And the network of stores that we acquired with the Paderno brand acquisition would be an example of store assets that we really didn't believe were delivering on either objectives, so we made the decision to shut these stores down in the quarter.

So our initiatives run the gamut, and the program management we put in place enables us to track and plan and hopefully manage in a coordinated manner, at least that's what we're hoping in terms of the dedicated overhead we've put in to manage the program.

Operator

The next question is from Irene Nattel from RBC Capital Markets.

Irene Ora Nattel - *RBC Capital Markets, Research Division - MD of Global Equity Research & Senior Equity Analyst*

I was wondering if we could just get some more color on the core Canadian Tire banner and the strength in the same-store sales in the quarter. Certainly, against the backdrop of rising e-commerce, those are very impressive numbers. So can you take -- walk us through how you're approaching all of your categories and what we should be expecting on a go-forward basis?

Gregory Huber Hicks - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

That's over to me again. You're looking for something more detailed than just great management, Irene?

Irene Ora Nattel - *RBC Capital Markets, Research Division - MD of Global Equity Research & Senior Equity Analyst*

Well, great management goes without saying. But yes, please.

Gregory Huber Hicks - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

If I had to narrow it down, Irene, I'd say there's 3 big drivers to the quarter's performance.

Number one. We won with our Triangle membership. Allan talked about some of the metrics across all of the banners. Our active Triangle member count grew by 5%, and their spend was actually up 8%. And active families, which is just kind of the target for us, which represent about 12% of our accounts, was actually up $40 million in the quarter. So it drove 30% of our growth. So we continue to be extremely relevant with active families.

Number two. I'd say we won the battle on digital customer acquisition. Our digital traffic was up over 20% in the quarter. That's millions and millions of visits. Susan and her team just did a fantastic job. And the traffic was tilted to big Q4 businesses, businesses like winter tires, Christmas, kitchen.

And number three, and really important, I think, for this quarter and important in terms of how the organization plans on a regular cadence, we won the must-win promotional days in the quarter. When you think about execution, especially in Q4 these days, you need -- it really needs to travel through key days and events. Events like Thanksgiving. In our case, Red Thursday, Black Friday, Cyber Monday, the days leading up to Christmas, Boxing Day, et cetera. And when we approached the planning process for this year, we had 6 less selling days between Black Friday and Christmas, which the team was a little worried about. So we put extra effort into focusing day-by-day from an execution planning standpoint, and I think it really paid off.

From an operational efficiency standpoint, if I put that hat on, most of this activity was done by -- without spending a lot more money in marketing to acquire these customers. So we were happy about that. And I think Allan touched on the fact that our dealers just play such a role. We saw material changes, even in the same market where you've had 20- to 25-degree swings in weather day by day. And the dealers dynamically reacted by market with fresh merchandising and inventory for whatever our membership needed.

Irene Ora Nattel - *RBC Capital Markets, Research Division - MD of Global Equity Research & Senior Equity Analyst*

That's great. That's -- and just wondering, can you give us an update on what percentage of transaction counts and what percentage of sales are related to Triangle?

Gregory Huber Hicks - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

In aggregate?

Irene Ora Nattel - *RBC Capital Markets, Research Division - MD of Global Equity Research & Senior Equity Analyst*

Yes, please.

Gregory Huber Hicks - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

I got to look at Susan for CTC or Allan.

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

Yes. Let's -- what I would do is give you some indicative numbers is -- it's always hard to give you a best-in-class because you get a general merchant, and you can't really compare that to a grocer, you can't really compare that to a mono line. But we would be in and about the 50% range. I mean when you saw the $2.5 billion in sales, you can kind of do the math. But in terms of sales going through the card and percent of transactions, we're about 50 -- in the 50% range. I'd probably just like to leave it there.

Irene Ora Nattel - *RBC Capital Markets, Research Division - MD of Global Equity Research & Senior Equity Analyst*

Okay. That's helpful. And finally, if I might, just a question on coronavirus and where you stand right now in terms of merchandise and when the next critical windows are and what contingency plans you might be putting in place?

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

Irene, it's Stephen. Okay. Just let me level-set just a little bit here, so you understand some of the facts surrounding this. But as far as our banners are concerned, we don't have any active vendors in the quarantine area, it's kind of the epicenter of the virus in China. So just so you know that.

And in terms of activity and manufacturing activity, we have always scheduled a significant amount pre the Chinese New Year. So that was all done quite some time ago. It's really more of a Canadian Tire retail story than it is the rest of our banners, but we're not seeing any supply chain or logistics or systematic supply chain issues arising at this point in time or ahead of us.

Keep in mind as well that we were well-stocked here going through for a number of months. But we've done business in China and have a relationship in China that is probably as good as any retailer in the world. We've been there for decades and decades and decades. Just take us right back to our vendor relationships, our transportation within the country, our relationship set supports the ability to move product from port to port, our ability to get our shipping lines to access product at multiple ports, et cetera, et cetera. So we have many, many people on the ground in mainland and in Hong Kong, I've had for years and years and years.

So we're monitoring this like everybody else in the world is monitoring it. I think the coming few weeks will tell us more about the longer-term implications to us. But at this stage of the game, it's just -- we'll keep an eye on it, but there's no systematic issues that we have to deal with, Irene.

Operator

The next question is from Mark Petrie from CIBC.

Mark Robert Petrie - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

I just wanted to follow up on the topic of e-commerce.

So obviously, it was a good grower and strong web traffic growth. But what has been the impact on the P&L? And I guess both on the fulfillment side, I understand the model, I think, but if -- any updated comments?

But then also just with regards to sort of the OpEx spending behind the scenes to be able to execute to this point. Do you feel like you've sort of moved through the most significant part of the investment or maybe you could just sort of talk about that?

And then I guess secondarily, coming out of the big season for e-commerce, would just be interested to hear any insights you can share about how dealers are approaching the opportunity.

Gregory Huber Hicks - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

Well, I can say...

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

I'll take a shot at this. I think that's the main one that we're seeing more numbers about than -- more on kind of the leading edge of what we're trying to do on e-com as a leader within the family. But obviously, e-com is more expensive. It goes without saying that behind that, we're trying a number of things. And Sport Chek is on our leading-edge of -- and Triangle's as well from free shipping to dollar amounts of purchases to trigger it, tying in our credit card, et cetera, et cetera, to all these sort of options.

I think what happens too over time, is that -- which is why we're pushing Sport Chek so hard, is that you learn a tremendous amount. If you are fulfilling orders from 2 different areas of the country, i.e., what's called split shipments in here, you're paying twice for the same sale. That simply means getting better at where you're putting your inventory and understanding what SKUs are actually driving 75% and 80%, 90% of your e-com business. So we've learned all that here, trying to get your pick cost down, et cetera, et cetera. Those are all hitting your margins. There's no doubt about that. But it's also trying to understand what happens when product flows back into your store and the opportunity to actually engage with the customer as product comes back into the network.

So absolutely, there is extra costs associated with your e-com business, but you become more efficient over time. And you're able to handle it over time, and you do it through your pricing and through a variety of other initiatives to drive more transactions. So from an e-com point of view, absolutely, there's additional -- many of what I just said doesn't particularly apply in the Canadian Tire Retail network. It's a different animal altogether in terms of forward deployed inventory and out of stores. And again, the ability of our dealers to handle our business in local markets, we could probably go on for 1.5 hours, to tell you the advantages of having local owner-entrepreneur on the ground in a city. It means we pay less for snow clearing -- removal at our stores, and we execute on e-commerce probably better than any of our competitors. So the Canadian Tire Retail is a different discussion point.

Mark's is not selling as much online as Sport Chek yet but can learn. So PJ and his team are just sort of studying everything that -- while TJ Flood takes is knocks learning this, and PJ is coming in way from behind. So I don't know. Was there a second part of the question I didn't answer?

Mark Robert Petrie - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

Yes. I mean I guess the second part was just sort of related to sort of changes in evolutions you're seeing in terms of customer behavior and customer expectations.

And then I guess specifically, with regards to the CTR banner, what are your sort of -- what did you see with the dealers in terms of them executing on home delivery versus third party?

And then what are your thoughts on free delivery at some point or in some form? And how should we think about the financial impact of that?

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

You want to do the CTS?

Gregory Huber Hicks - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

Sure. I mean overall -- it's Greg, Mark. Overall, for sure, to Stephen's point, the dealers are very, very supportive. I mean they really see the benefit of choice at the customer level. I mean I often get asked about kind of the e-commerce business and the BRICs business, it's really -- that's the wrong question because customers are engaging with us. The same customer is engaging with us across multiple channels, so it's really about the customer. The dealers see the benefit of providing the customer choice. So we end up, every quarter, extremely busy with the dealers on e-commerce. I think we collectively believe, for some of the reasons that Stephen just outlined, that in-store pickup is -- continues to be the best way for our customers to have their orders filled as it's always the fastest and the cheapest option. We've had tremendous success with all forms of e-commerce. Our ship-to-home business was up almost double in the quarter. This is the first comp quarter of ship-to-home and CTR.

But we're really working with the dealers now on rolling out more automated pickup solutions to really improve the customer experience and the dwell time for the customer. So you can expect to see lockers roll out to a few hundred stores in 2020. We tested them in 2019. Just a fantastic customer experience from an NPS standpoint. And so we're really getting behind that as we move forward in 2020.

From a free delivery standpoint, I know that's on your mind there, Mark. We have, and continue to go to market with a -- or a high-level strategy at the product level. That's our primary means for driving customer acquisition. To the degree that freight is a more attractive kind of acquisition tool -- incentivized freight is more of an attractive tool than discounting product, I'd imagine that's something that we're going to look at with dealers. But at this point in time, we don't really see a need. And I guess we'll keep you updated as those conversations progress.

Mark Robert Petrie - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

Okay. And then just quickly, Dean, you mentioned the dealer margin true-up. Was there any impact in Q4?

Dean Charles McCann - *Canadian Tire Corporation, Limited - Executive VP & CFO*

No.

Operator

The next question is from Peter Sklar from BMO Capital Markets.

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

I just have -- just one question and it's on the credit metrics within the credit card portfolio.

So like, if you look at the statistics, the PD2 was effectively flat but the net write-off rate inched up a little bit. And Dean, in your commentary, you said that would be a natural expectation given the high growth you've had over the last number of quarters in terms of new account acquisition and growth in GAAR. So could you please explain why the creep up in the write-off rate is something you would naturally expect?

Gregory Huber Hicks - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

Sure, Peter. It's Greg here. If you -- and this isn't Canadian Tire-specific. If you look at the industry, our credit card acquisition, what you'll find is about months 12 to 18 for any new account is when you'll reach your peak in terms of charge-off. It's just as you're getting to learn the customers. So what will happen is if you acquire 100 customers, as I said, around 12 or 18 months in, you'll experience the initial loss from those -- from that group or that tranche of new accounts. And as we've used the word before, it kind of rinses its way through after that.

So as any time we've acquired new accounts, and I go back 10, 15 years ago to what we just did with Triangle, when we have a period of great growth in new accounts, it's usually followed -- lagged a little bit by an increase in our charge-off rate. And that's what Dean was alluding to.

But I just want to reinforce again, if you look at our new account vintage curves, so what that does is it takes a look at all the accounts we've acquired in their first month of behavior across multiple time periods. There's sixth months of behavior, there's 12th month of behavior. We are not seeing any deterioration in any of their behaviors, so the customers we're acquiring are very similar to the customers we would have acquired 5 years ago, 9 years ago. That's pretty encouraging for us and as Dean said, we're right in line with our expectations of what we would have thought would have happened both from a write-off perspective and an aging perspective as well.

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

So why did we not see for that vintage then that's now entered the 12- to 18-month window? Why would we have not also seen, like, first, you would see -- they would have gone past due, so why did we not see a slight spike in the PD2, which has effectively been flat?

Gregory Huber Hicks - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

We have to remember, there's a couple of things in write-offs. There's different ways you can charge-off, as you know. So what you usually get with the PD2 is the -- is as accounts age, they can't make their payments. And after 6 months, we call it a regular write-off. They flow through the charge-off. The other way you can write-off is through bankruptcies and through proposals. So it's the combination of all the elements that drove up kind of the write-off rate. The aging is just what you're seeing, the natural maturation. You do see some accounts that will choose the bankruptcy route or the insolvency route, is how I'd answer your question.

Operator

The next question is from Vishal Shreedhar from National Bank.

Vishal Shreedhar - *National Bank Financial, Inc., Research Division - Analyst*

Just on the comps, a solid performance and I know management alluded to weather being a factor but not the only factor, and I know that the weather was uneven through the quarter. So I was hoping you could give me some context by banner, to what extent you think the early winter weather might have helped just so we can get a sense of what a more normalized quarter would have looked like, if that makes sense, what I'm asking.

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

Well -- Vishal, it's Allan. I'm still waiting for the normal quarter. It seems like there's always some either headwind or tailwind or last year they were comping over that that causes complexity. And when you're looking at weather, generally speaking, it has an impact, as you well know. But at CTR, if you get weather early, that has a different effect. And if you get weather late, a category, then you have the nonweather seasons like Christmas that ramp up and sometimes get inhibited by snowstorms when people can't reach the store. Sport Chek and Mark's have a different perspective on that. But what I would say is that over the course of the quarter, like every quarter, you try to respond to it as best you can. But it's really a category-by-category answer to be perfectly honest, unless you have big anomalies like we did last April, where we had snow for the month of April. I mean that has far sweeping impacts. But this one would be a story about industrial wear in Alberta, the impact of skiing in Québec and winter tire sales at CTR. You kind of get into that level of granularity.

Vishal Shreedhar - *National Bank Financial, Inc., Research Division - Analyst*

Okay. So just at a high level, would it be fair to say that across the banners, weather was generally favorable? Or is that not a fair comment?

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

I think that for the most part, yes, weather was generally favorable. I mean the business unit leaders are here. I don't know, Greg or TJ?

Gregory Huber Hicks - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

It's Greg, Vishal. I would just say, one of the things that we've talked about over the course of many calls is just the health of our nonseasonal business, which is a really good book of business. It's about 50% of our sales annually. And in the quarter, that tracked almost right on the aggregate comp line. So we were close to the 5% level. So there was a -- generally favorable, I think, is the way to kind of extrapolate it for Canadian Tire, but we feel really good about that nonseasonal business, Brooks standing up tall in the quarter as well.

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

Vishal, it's Stephen. I look at it slightly differently than that. You shouldn't look at it through weather. You should look at it as to whether the products that we have on for sale, that, if the market -- if the general seasonal conditions are available, they can go to any retailer and pick them up. What happens is they came to Canadian Tire. Our traffic was up substantially, our sales drew a high-value -- customers and our loyal customers are up substantially, our web traffic is up substantially. So all other things being equal, up against the competition, we had to steal market share. So the whole thing is it's not weather-driven, it's how successful your business is against everybody else's.

So over time -- the reason we put out a 3% comp figure is because over time, that's roughly what we aspire to. And you're going to go up and you're going to go down. But if we had fantastic weather in the fourth quarter and our banners didn't perform, we would be extremely concerned. And so therefore -- and we did perform better, I think, than probably most retailers in the country.

Operator

The next question is from Brian Morrison from TD Securities.

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

I just have a quick follow-up question on Financial Services. Just with respect to color on leverage that you got, both within gross margin and SG&A. I realize there's going to be some benefit from volume here, but is this great leverage that you achieved, is that a function of the shift towards account aging and away from account acquisition taking place?

Gregory Huber Hicks - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

Yes, Brian. It's Greg here. Thanks for the question. So as you know, we had earnings growth of around 19% in the quarter versus Q4 a year ago. And I'd point to the 3 things.

First and foremost, we had continued strong growth in receivables, being up 5% in the quarter certainly contributed to that income growth.

The second thing you just alluded to is exactly right around our operating expense ratio. We improved fairly significantly from where we were on a rolling 12 basis a year ago. And 2 components to that. One, of course, is, as you said, moving from acquisition, which can tend to be a bit more costly, the kind of ongoing engagement certainly helped the operating events ratio. Plus just generally, as Greg talked about, kind of the OE initiative working its way through CTC. I think there's also a piece of that in the results as well.

And the third thing I would point to the results also is it relates to the allowance. If you think about it, last year, we grew by 11.5% in the fourth quarter, so that's a pretty significant growth rate. So that had a fairly significant allowance growth that went with it given kind of IFRS 9. We had 5% this year, which was great, but then it's just not as significant of an allowance build as we would have had a year ago. So the 19% would be kind of a combination of those 3 factors on a year-over-year basis.

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

Is it fair to say that this trend continues in 2020, we should see continued improvement in operating leverage, Greg?

Gregory Huber Hicks - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

Yes. I think from the OpEx perspective, I think we're going to continue on this engagement journey. I think we've seen some early data that indicates it's kind of working, but it's early data. And Mahes and the team will continue to make that much better after I leave, I'm sure. But it is going to be an area of focus going on into the near term. I would think for sure.

Operator

The next question is from Derek Dley from Canaccord.

Derek Dley - *Canaccord Genuity Corp., Research Division - MD & Consumer Products Analyst*

Just one for me as well. Just in terms of -- on the retail margin. Obviously, you had some nice growth when adjusted for Petroleum.

Can you just talk about what were the drivers were that led to that margin growth? And if you're seeing -- if you're getting any benefit or if you're seeing any sort of pricing return to the channel?

Gregory Huber Hicks - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

CTR, if you want, after.

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

What's that?

Gregory Huber Hicks - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

I can do CTR, if you want, after.

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

Yes. I think generally speaking -- so in terms of margins, we're continuing, as Stephen said, to go after demand in the market, put up a really strong offering. And when we talk about things like the value of our loyalty program; the value of having a curated assortment; the value of having a good balance between national brands that customers covet and our own brands; the digital experience; the in-store experience, which is we put particular focus on in the last couple of quarters; all of these things contribute to our ability to manage margin differently. They contribute to our ability to watch our promo investment, to be able to command strong reg pricing. And ultimately, you have to be price-competitive and experience-competitive in the market. And when you are, you get to see good margin contribution if you manage well. So I'd say, broadly speaking, we're quite obsessive about that internally and working really, really hard to make sure that we're able to be market-competitive in all of these areas and continue to grow the business.

Category by category, obviously some are more competitive than others. But as a general rule, everything that we're doing is really about being able to maximize the margin benefit that we get from the transactions we have with our customers. Greg, I don't know if you want to say anything more in CTR?

Gregory Huber Hicks - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

No. I think that's fine.

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

All right. I'll just leave it at that, Derek. Thanks.

Operator

The next question is from Patricia Baker from Scotiabank.

THOMSON REUTERS

Patricia A. Baker - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Stephen, this is for you, and I'm not sure that you're going to provide me with an answer. But since in your remarks in the press release, you noted that the top line growth that you're seeing, and you noted that Triangle is driving and making Canadian Tire one of Canada's largest e-commerce players.

Now we know that your e-commerce sales are something north of $500 million. Is there any way you can provide us with some better context for why you can make that statement? How -- are you #2, #3? How far ahead are you of the players down the list? Where are you with respect to the largest e-commerce player in Canada?

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

Well, I think we could probably -- I'll tell you to guess, Patricia, as to who is the largest is in share in the country.

The benefit of us trying to give a little bit more disclosure in the third quarter of last year was that when -- over the prior 12 months probably, questions were all over the place in terms of what's the e-com, where are you going, how well are you doing, even challenges to us in the press saying, "I wonder where Canadian Tire will be given all this e-com activity," et cetera, et cetera.

At that point in time, primarily, Susan O'Brien and John Koryl were building what we believe to be an extremely competent and efficient marketing and execution engine for digital. And so we thought the third quarter was a good time for us to try to tell all of you and everyone else listening that there's not many retailers in the country that would be well in excess of $500 million on e-com. So we are one of the top players in the country. And we tried to give you some color last month for that.

We are growing at industry or above industry rates. We have a large fourth quarter that has a significant portion of it attributable in terms of revenue to e-com, as you know. And we continue to believe that we're a very significant e-com player in this country. And that's the context of it as opposed to saying, here are the top 10 and we're #6. So that's I guess to give you some context of why I say it in the script.

Operator

The next question is from Chris Li from Desjardins.

Christopher Li - *Desjardins Securities Inc., Research Division - Research Analyst*

My apologies if you have answered this partly on the call already. But just taking a step back, I was wondering if you can talk to us a little bit about what you're seeing in terms of the health of the Canadian consumer.

I know in the past, you said you look at a few things like purchase of high-ticket items or trading downward shift in the repair and maintenance category. Just wondering if you can comment on just overall health of the Canadian consumer.

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

Look, I'll make a couple of comments and my colleagues and John, or whoever they would like. There's some -- actually great articles across the national newspapers in the course of this week in terms of consumer confidence across the board and the Bank of Canada, for that matter.

And what everybody is talking about continually in the press is just not being seen within the real numbers in the economy. The economy is strong as far as we're seeing it. Consumer demand is. And so across our businesses, this wouldn't -- well, I suppose, yes, business would be a little bit of an indicator, I suppose, of any sort of weakness in the economy, which we didn't particularly see.

During the course of the summer, we see a lot of activity when the economy is in poor shape, repairing as opposed to buying new.

Having said that, we're just not seeing it nor are the other retailers nor are the banks and nor is the Bank of Canada. So we remain extremely optimistic. And can't shed more light on it than that. And we're looking forward to a very good 2020 year, actually.

Christopher Li - *Desjardins Securities Inc., Research Division - Research Analyst*

Okay. Now that's helpful. And then maybe just a question on shipping cost. One of the other large general merchandise retailer in Canada have recently said that they expect shipping rates to be up this year because -- partly because of IMO 2020. Wondering if that's going to have an impact on you guys as well.

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

Yes. It will overall, but I -- you have to accommodate it. It's not dissimilar to when minimum wage rates went up. Virtually every retailer, except us, complained about it. We just assumed it, consumed it, continued to operate, and now nobody talks about it. And so with things like this, we're experiencing increased shipping rates right across the board in all our businesses around the world, actually, getting product in, not just within a Canadian context.

So efficiency. The areas that I mentioned earlier on e-com, like split shipments, putting your inventory in the right place, et cetera, et cetera, et cetera, mean a tremendous amount to us. So we're getting more efficient on that side. And you're continually in a headwind in fighting other increased costs. But I think we're in a great position in it. You will not see a material impact to us based on that in 2020.

Christopher Li - *Desjardins Securities Inc., Research Division - Research Analyst*

Okay. And then just my last question is given this year-end, I was wondering if you can share with us what was your own brand penetration for CTR for the year? And what was it, the year-over-year change?

Gregory Huber Hicks - *Canadian Tire Corporation, Limited - President of Canadian Tire Retail*

We ended up just over 37% penetration for the year, and it was up about 170 basis points. The team has a well-architected strategy for the next 5 years, and we would expect that penetration pace, plus or minus 10 bps, here or there organically. So we see a runway for another 7 or 8 points of penetration in the next 5 years.

Christopher Li - *Desjardins Securities Inc., Research Division - Research Analyst*

Great. And Dean, all the best in your retirement. Well deserved.

Dean Charles McCann - *Canadian Tire Corporation, Limited - Executive VP & CFO*

Oh, thanks, Chris.

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

It is well deserved.

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 Investor Relations if there are follow-up questions regarding today's call or the materials provided. You may now disconnect.