Will This Canada Goose Honk for Investors?

Description

Dear Fellow Fools,

Ah, the "IPO".

I wonder how many of us had even heard of such a thing prior to the late '90's when tech IPOs were trumpeted by daily headlines and provided 1,000% opening day moves (based on loose recollection, perhaps a slight exaggeration).

The initials stand for "Initial Public Offering," and this generally refers to a time in a company's life when it moves from the world of being privately owned and into the throngs of the oft-eagerly awaiting public markets.

Who doesn't remember where they were the day that the likes of **Facebook** or **Alphabet** or, once again harkening back to the late '90's, **Amazon** made this very leap?

And, with the S&P/TSX Composite recently joining its U.S. brethren by achieving an all-time high, now seems like as good a time as any for privately-owned companies to make this very same leap.

We've already seen two relatively high profile IPO's in the Canadian market in recent months. Retailer **Aritzia** made its debut in September, and restaurant chain **Freshii** listed in January.

On Wednesday, it was announced that parka maker **Canada Goose Holdings** is planning a US$200 million IPO, which represents about 10-15% of the company, thus valuing it in the $2 billion range.

Not too shabby for a company that makes a product that's out of the price range of many. After all, a Canada Goose-branded jacket *starts* at about $800.

What's the deal?

Canada Goose is currently owned by its founding family (CEO Dani Reiss owns 30%, his grandfather founded the company in 1957), as well as US-based private equity concern Bain Capital, which acquired its stake in 2013.

These two parties represent the selling shareholders. Though, as indicated, both will remain in the mix…For now.

It can be expected that, with time, depending on how the stock performs of course, more and more of this company will be sold to the public.

We investors are on the other side of the table, so to speak. And for us, the question that needs to be answered is whether or not we should be lining up to buy shares from these sellers.

Right off the bat, do you see a potential issue here?

Presumably, the company's CEO and Bain Capital know Canada Goose pretty well. Probably better than you or I.

Right?

Yet, they're the ones ***selling*** shares, expecting us to buy them.

This is *always* an issue with IPOs and, at the very least, should cast a shadow of skepticism over the whole process.

The other overarching issue that virtually *always* crops up is that the selling shareholders generally demand a rather rich, oftentimes ludicrous valuation.

Case in point…With Wednesdays' filing, we got a look at some of Canada Goose's financials.

In fiscal 2016, the company earned revenues of $290.8 million and net income of $26.5 million, indicating that these figures grew at a compound annual growth rate of 38.3% and 196% respectively between 2014 and 2016.

Pushing those growth figures aside, assuming a $2 billion valuation, this translates to a Price/Sales multiple of 6.9x and an earnings multiple of 75x.

To give these figures some context, check out the diverse collection of retailers and the multiples at which they trade in the table below:

Company Name	P/S LTM	P/E LTM
Under Armour, Inc.	2.0x	39.8x
NIKE, Inc.	2.8x	33.8x
Fossil Group, Inc.	0.3x	11.5x
Coach, Inc.	2.3x	25.6x
Michael Kors Holdings Limited	1.4x	10.5x
Lululemon Athletica Inc.	4.1x	37.6x
American Eagle Outfitters, Inc.	0.8x	12.6x
Average	*2.0x*	*24.5x*

Data provided by S&P Global Market Data

Suffice to say, Canada Goose shares **aren't cheap!**

The business

The only way to justify paying the sky high multiples that are on offer is to believe that Canada Goose is going to **grow** at a far greater clip than the companies tabled above.

Hmmm…

Colour me skeptical. There's that word again.

Now, I'm the last person in the world that should be commenting on something clothing related. Nor will I ever really understand the world of premium-priced retail.

I do, however, know something about winter and geography.

Here in Canada, Canada Goose is a pretty well-known brand, even though it's not affordable by all – yours truly included. We obviously have winter that covers much of our population.

To grow though, the company needs to look outside of Canada. There's no two ways around it.

Thing is, that its product line is solely winter-oriented significantly shrinks its potential market relative to the companies mentioned above.

Yoga pants or running shoes are worn all year round from Russia to Australia to the west coast of the U.S. On the flip side, winter hardly exists in 2 out of 3 of those locales.

Which means, whereas many clothing manufacturers and distributors are truly playing in front of a global audience, and therefore market share isn't the be all and end all, to grow, it seems to me that Canada Goose is going to require a disproportionate share in the markets where its product is relevant.

Given its price point, which already segments the market, this may prove challenging.

The prospectus indicates that recent growth related investments have been focused on North America, and especially the U.S. To illustrate my point, I'd estimate that about half of the U.S. population doesn't even require a Canada Goose-like product to survive winter. And less than half of the population that *does* require winter wear probably can't afford this offering. Again, estimating.

The company has seemingly gained traction in the North East, and sees opportunity in the Mid-Atlantic, Midwest, and Pacific Northwest. And indeed, U.S. revenue growth has been robust, increasing at a rate of 75.5% annualized between 2014 and 2016.

But can this continue???

Certainly not indefinitely. Guess what you can colour me…

Foolish bottom line

To be sure, Canada Goose is a great Canadian success story. I don't mean to slight the company in the least. I'm just wary of its merits as an investment, at least out of the gates.

As is generally the case when it comes to IPOs, my suggested strategy is to avoid the hype and put Canada Goose on the back-burner with the intent of revisiting after it gets a few quarters under its belt. If the opportunity truly is *that* good, you won't be missing anything, and given the current valuation, it's hard to imagine the company getting *more* expensive, at least in the short-term.

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