Why I Wouldn't Touch Shares of Aritzia Inc.

Description

Aritzia Inc. (TSX:ATZ) has been a tough stock to own for investors that jumped in shortly after the IPO last year. The stock is now down approximately 20% from its high, and the negative momentum has turned it into a falling knife. It's never a good idea to catch a falling knife, and it's an even worse idea to attempt this if the business is in a fickle industry.

Aritzia is in the general fashion industry, which is incredibly cyclical and will crash hard once an economic downturn happens. But what is "general fashion," exactly? Aritzia designs and produces a wide range of clothing items aimed at women between the ages of 14 and 30. As you can guess, there are a ton of different clothing items that are produced with its brands like TNA, Talula, and Wilfred.

These pieces of clothing are highly vulnerable to sudden changes in fashion. One day a particular article of clothing may be selling like hotcakes — the "hottest" fashion out there. The next day it could quickly "go out of fashion" and sales could be few and far between. If Aritzia overproduced a certain clothing design, and it goes out of fashion, then the company will be left with excess inventory and will have to resort to discounting, which is not great for margins.

In general, margins are pretty good, as the clothing Aritzia sells is often priced way above what it costs to produce. Aritzia isn't a luxury good by any means, but the brand is quite powerful, and women between the ages of 14 and 30 seem to be willing to pay high prices for Aritzia's designs.

Because of this, it can be really difficult to determine where earnings will head because one disastrous quarter could be followed by a fantastic one. The fashion industry is really hard to predict, so investors should be prepared for stomach-churning amounts of volatility over the long term.

Beware analyst price targets

Many analysts had unrealistic 60% upside price targets on the stock; they were too bullish when attempting to predict the company's earnings and cash flow. As an investor, you should treat analyst price targets with a grain of salt.

Sure, there's a lot of upside potential, as the company is opening more stores south of the border, but I think it's way too difficult to predict where earnings will be in a year or in five years from now. General fashion is a tough business, and price targets can be very wrong on occasion. Many analysts have since downgraded price targets after the stock showed weakness, and the investors who blindly followed these price targets are hurting right now.

There's definitely upside potential, but Aritzia and the general fashion industry are extremely volatile and unpredictable. If you're not comfortable with that, then I'd avoid Aritzia like the plague.

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joefrenette