Could Investors Be Underestimating the Power of Aritzia Inc.'s Brands?

Description

I've been bearish on **Aritzia Inc.** (TSX:ATZ) since the company's IPO last year. The company is in the frightening general fashion retail industry, which is not doing too well of late. Aritzia is a very interesting high risk/reward play. The brand is strong, and young women can't get enough of Aritzia's clothing. The company has great growth prospects, and the management team has been incredibly effective at driving traffic at a time when many other Canadian fashion retailers are on their knees.

Many analysts have been overly optimistic on Aritzia since its IPO, and the price targets have been quite unrealistic from the start. Analysts from across the board started downgrading Aritzia after the company took a plunge, and many IPO investors were left scratching their heads.

As I've emphasized in past pieces, the general fashion retail industry is incredibly unpredictable. This is the kind of stock that Warren Buffett would avoid, but that's because it's outside his circle of competence. Everyone is scared to death of the fashion retail business right now, and this industry-wide weakness is hurting Aritzia, even when it posts decent results for its quarters. For fiscal Q1 2018, the company saw its profit and sales increase by 4.9% and 14.7%, respectively. E-commerce has been growing, and things appear to be doing better than the company's current stock price would indicate.

Shares of Aritzia trade at a 9.89 price-to-earnings multiple, a 6.8 price-to-book multiple, and a 2.1 price-to-sales multiple. That's a low price to pay for a business that has grown its revenues and kept its gross margins around the 40% levels. Those are impressive margins for a company in the clothing industry — way above average. Aritzia is able to command premium prices for its products because of the power of its in-house brands such as TNA, Wilfred, and Talula. Aritzia's fashions aren't high-quality products either, but the brands allow the company to get away with its high prices.

The management team has also spun off Aritzia's brands into their own stores, which I believe is a very smart move to drive traffic and freshen things up. A particular mall may have two Aritzia-owned stores, and a consumer is very likely to visit both since both stores offer vastly different types of clothing.

Bottom line

Traditional valuation metrics don't account for the true power of Aritzia's brands. The company has a large cult following, which will allow it to excel in an economy where consumer spending is up. The company has consistently developed fashions that attract women between the ages of 14 and 30 over the years, and I expect more of the same going forward.

Shares of Aritzia are cheap, but they're still quite risky. I'd avoid shares until they drop below the $13 levels. Until then, you might want to add ATZ to your radar.

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