Canada Goose Holdings Inc.'s Q2 Provides Many Reasons to Stay Away From the Stock

Description

Canada Goose Holdings Inc. (TSX:GOOS)(NYSE:GOOS) released its first-quarter results for fiscal 2018 which showed positive sales growth and a smaller loss from a year ago. The company's revenue totaled $28 million and represents a year-over-year increase of almost 80%. However, the company still produced an operating loss of $14.7 million, which was only slightly improved from a loss of $14.8 million in the prior year.

Canada Goose posted a smaller loss than expected, but there are many reasons why I wouldn't invest in this company.

Inflating costs

Despite the company seeing gross margins improve from 30% a year ago to 47% in the current period, a 43% increase in selling, general, and administrative costs eroded those additional margins. Canada Goose's loss before taxes was flat from the prior year, and the improvement in the bottom line came as a result of an increase in income tax recoveries for the current quarter.

Lack of cash flow and poor liquidity

The company continues to struggle to produce cash flow as operating activities depleted the company of $80 million — up from $60 million a year ago. As a result, the company had to borrow over $90 million from its revolving facility. The problem with the additional borrowing is that the company already has a term loan of $136 million, which represents more than Canada Goose's total equity.

The company paid almost $2.5 million in interest this quarter, more than quadruple the $585,000 it paid last year. If Canada Goose continues to add to its borrowings while failing to see improvements in cash flow, the company could find itself in a difficult situation. Despite Canada Goose having a strong current ratio that sees assets being 4.15 times the size of liabilities, without the high inventory load, that ratio drops to just 0.76.

Accumulating inventories

Canada Goose has been building inventories and, year over year, has seen an increase of over 41% for a total of over $51 million more in inventory this quarter. Although inventory may contribute to the company's ratio and may make it look more liquid, I'm sure **Sears Canada** can attest to the difficulty in moving inventory in times of liquidation and being able to get anything close to market value.

High-risk receivables

The company has also seen problems with its receivables and has had to insure over 85% of the money it is owed. The problem I see is that the company's allowance for doubtful accounts of $1.4 million is almost 15% of its total receivables of $10 million. However, the current quarter's doubtful allowance is actually an improvement from the previous quarter when the company's allowance made up over 23% of total receivables.

Premium clothing in a rising rate environment

As interest rates rise, banks will be looking for higher mortgage payments, and that will inevitably lead to smaller budgets for consumers. Perhaps I do not see the vision, but I cannot fathom a scenario where I would need to purchase a $750 winter jacket. Canada can get very cold, and I've had the pleasure of shoveling snow the past winter in -30° temperatures, so I can appreciate the importance of warm winter clothing.

The problem is, I can buy adequate clothing in the mall for a fraction of the price of Canada Goose's apparel and still stay warm without burning my wallet.

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djagielski