The Real Estate Market Is Weakening: Here's Why Canada Goose Holdings Inc. Will Feel the Pinch

Description

It seems the government's plan to slow down the housing market to make it more affordable for homebuyers again has worked.

A 15% foreign buyers' tax, rising mortgage rates, and tougher lending rules that include stress tests to ensure buyers can still afford the house under higher interest rates worked together to send home prices crashing down.

Apart from the obvious effects of this on the housing market, I wanted to look at the effects that declining home prices have on the consumer's real and/or perceived wealth.

Just as rising home prices led consumers to "feel" wealthier by borrowing more off of their lines of credit and spending more based on their evaluation of their wealth, the opposite should be true in times of declining home prices.

The following two retail stocks are therefore vulnerable, and I would consider this risk if I owned them…

Canada Goose Holdings Inc. (TSX:GOOS)(NYSE:GOOS) has been expanding globally, but 39% of its revenue still comes from Canada. As such, it is still vulnerable to a weakening in Canadians' purchasing power.

In the latest quarter, the company reported that total revenue increased 27%, gross margin increased to 63.6% from 57.5%, and earnings per share was $0.58, a 49% increase from last year.

That represents significant growth, yet the stock tanked 16% right after the release, a sign of elevated expectations and of overvaluation.

The stock still trades at 63 times 2018 expected earnings and 50 times next year's expected earnings.

While earnings per share increased 49% in the latest quarter and is expected to remain strong with a 2018 expected earnings growth rate of 58% in 2018 and a 26% growth rate expected in 2019, the stock is clearly very richly valued to the point of being overvalued.

The company has numerous other risks, including its concentration risk given that 98% of its sales are in outerwear, and the potential problems that may arise given PETA's vocal opposition to Canada Goose using goose, duck feathers, and coyote fur in its apparel.

Roots Corp. (TSX:ROOT) is another such company that is vulnerable to a weakening of the Canadian consumer.

But it is trading at a much more reasonable multiple of 17 times this year's expected EPS, with an estimated earnings growth rate of 17%.

In its 40 years, Roots has been a powerful brand known for its quality and style. In the last three years, the company has grown its revenue at a CAGR of 14%.

Future growth plans include investing heavily in the U.S., expanding internationally in Asia and other international markets, as well as investing in e-commerce.

In summary, I would take this information into account when considering investing in Canada Goose, as it appears that the risks to this stock are mounting.

CATEGORY

1. Investing

TICKERS GLOBAL

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2. TSX:GOOS (Canada Goose)
3. TSX:ROOT (Roots Corporation)

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