Warning: Canadian Retail Stocks Facing Strong Headwinds

Description

Canadian household debt has crept up again in the second quarter, as the debt-to-disposable-income ratio hit 169.1%.

Consumer spending is probably headed lower, which is what we would expect given the cooling housing market and rising interest rates.

So, what is the takeaway for investors?

Well, I think that investors have to pay attention to this as it relates to some of the “favourite” retail stocks out there, some that keep going strong, and some that have faltered and that investors may be tempted to think will come back — stocks such as **Roots** (TSX:ROOT), **Aritzia** (TSX:ATZ), and **Indigo Books and Music** (TSX:IDG).

Danger signs are already appearing in some of the results, so this risk can no longer be ignored.

Roots stock is trading below its IPO price once again — in fact, well below — more than 35% lower, to be more precise, as the stock continues its volatile ride. I do not view valuation as attractive on Roots stock, although it is quite low, at less than 10 times earnings.

Because the challenges remain and with second-quarter results that have come in below expectations, as same-store sales increased a very modest 1.1%, the future is unclear. And with slowing consumer spending, the company will have added difficulties with its expansion to the U.S., which has proven to be a very risky move, even in the best of times.

Aritzia stock is 59% higher than its 2016 IPO price of $16, and the stock looks reasonably valued at this time, as the company has continued to post very strong results. The company achieved same-store sales growth of 10.9% in the latest quarter, the first quarter of fiscal 2019, with a 22.2% increase in net income, as the retailer opened two new stores and expanded two existing stores.

Indigo stock is coming off a period of strong same-store sales growth and expansion, one that seemsto have slowed a bit in the latest quarter, but the story has only just begun.

The CEO has said that the goal is to position Indigo as the department store of the future, and given the shake-up in the Canadian retail industry, we can see that there is demand for something different. With newly renovated stores continuing to deliver double-digit same-store sales growth and continued strong online growth, the company is capturing market share at a feverish pace.

The retailer's U.S. expansion is moving forward, with the first U.S. store open in New Jersey. This presents a big risk but also big potential return, and given that the company is moving slowly with this expansion, the hope is that the risk is kept to a minimum.

Recent results show a hit to the company's profitability due to the growth phase they are in, but in my view this is short-term pain for long-term gain.

So, all in all, there are mixed results from the retailers, but one thing is for sure: the macro-economic background is showing more and more risk, so investors should be mindful of this.

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2. TSX:IDG (Indigo Books & Music)
3. TSX:ROOT (Roots Corporation)

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Date
2025/08/19
Date Created

2018/10/18
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