3 Reasons to Avoid Roots Corporation (TSX:ROOT) Stock

Description

This past week I'd covered three stocks in the retail sector that were worth monitoring ahead of the holiday season. Unfortunately, not all stocks in the retail sector are created equal.

Roots (TSX:ROOT) is about to reach its one-year anniversary since being listed on the **Toronto Stock Exchange**. There has not been much to celebrate for those holding shares in recent months. The stock had plunged 44% over a three-month span as of close on October 18. Shares were also down 49% in 2018.

It's always a good idea for investors to be on the lookout for discounts during stock market turbulence. The most recent global stock market sell-off has generated some attractive opportunities. Roots does not have the makings of a buy-low candidate as it stands today. Let's examine three reasons why investors should continue to avoid investing in the Roots brand.

The retail sector is rife with risk

Roots and other clothing companies have made a concerted effort to expand e-commerce offerings as traditional retail faces an ongoing decline. This was illustrated by the Chapter 11 bankruptcy filing from **Sears Holding Corp.** this month.

Although Sears has been in business for 132 years, the company has struggled to maintain profitability through its retail sales network. Some readers will remember Sears Canada ceasing operations in January of this year.

Roots ended the second quarter with 122 stores in North America. This represents a rather large retail footprint. Instead of scaling back, many companies like Roots have opted for renovations that are more geared to the modern shopper.

More pressure on Canadian consumers

Bank of Canada is set to hold a meeting on October 24 and will announce a decision on interest rates afterward. Even with the current choppy market, odds are the central bank will opt to hike the benchmark rate to 1.75%. Increases to the benchmark rate have been incremental, but have still had an impact on Canadian consumers.

Canada possesses one of the highest rates of debt-to-income in the developed world. Environics Analytics said that Canadian debt rose by 4.5% in 2017 and the average interest-expense-to-income ratio rose 40 basis points to 6.4%. The average Canadian household spent over $500 on interest charges in 2017.

This added pressure on consumers could spill over to trouble for the retail sector, especially during the holiday season.

Earnings have failed to impress this year

Roots released its second-quarter results back on September 12. Adjusted EBITDA fell by over $1 million year-over-year to $32,000 and the company reported a basic loss per share of $0.10 compared to $0.08 per share in Q2 2017. Roots has reported a net loss of $9.6 million in the first six months of 2018 compared to a net loss of $8.3 million in the first half of 2017.

Roots re-affirmed its outlook for the rest of the fiscal year, but its dip in the second quarter is troubling. The company managed to bounce back with strong earnings from the holiday season of 2017, but the headwinds we have discussed today could limit its ability to improve on the previous year. Roots stock looks like a falling knife right now, and investors should avoid it in the fall.

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