Investors Beware: The Free Fall Continues for This High-Growth Stock

Description

The TSX Index isn’t home to nearly as many initial public offerings (IPOs) as the markets south of the border. As such, there is usually considerable excitement in anticipation of TSX IPOs. Unfortunately, not all IPOs are created equal. Research has shown that retail investors who jump on the bandwagon immediately once the stock begins trading tend to underperform.

Case in point, **Freshii** (TSX:FRII). Any investor who’d purchased upon open in January 2017 would have seen their holdings plummet by 80%. Ouch! This year hasn’t been any kinder to the company, as its stock price has been steadily trending downwards. Now trading near 52-week lows, the company has dropped 65% from its January 3rd high.

Give the massive decline, should investors take a flyer on this once high-growth company?

Recent quarterly results

Before jumping in to any investment, it’s best to understand the company’s financials. Are they improving or deteriorating? On November 7, Freshii released third-quarter results, and it was ugly. The company missed on both the top and bottom lines. The company posted a net loss of $0.01 per share, whereas analysts were expecting earnings of $0.04 per share. Likewise, revenue of $5.6 million was lighter than the $6.07 million expected.

Another red flag was the poor performance of same-store sales. Sales at stores open for at least a year dropped by 0.8% over the third quarter of 2018. In comparison, the third quarter of 2017 same-store sales saw 5.1% growth.

On the bright side, the company is still growing. Revenue increased 27% over the third quarter of 2017 and are up 31% over the first nine-months of the year. This is still a company with significant growth potential. Likewise, the company announced its intentions to repurchase up to 10% of its float, as it believes its shares are significantly undervalued.

There is one other aspect worth pointing out. The company has no debt and has been able to fund

2018 growth entirely through cash generated from operating activities.

Poor execution

More concerning was the company's announcement that it intends to no longer provide guidance. This was effective immediately upon the release of third-quarter results, and, as such, it withdrew its 2019 outlook. Previously, it had guided to $285 million in sales from 760 stores, up from its current count of 431 franchised and company-owned locations. It had also anticipated same-store sales growth between 3% and 4% through 2019.

So, what gives? Management appears to be unable to execute.

It has had issues with timely store launches and has seen expenses rise. Management also admitted that its marketing and sales initiatives failed to deliver as expected. In other words, it over promised and under delivered.

As an example, the company opened 18 new stores in the third quarter. Yet it also closed eight stores for a net new store count of 10. For a new company such as Freshii, the number of store closings is alarming. Management has not been adept at strategically locating its stores.

Foolish takeaway

Despite trading at 52-week lows, investors should avoid Freshii. It's trading at 3.96 times sales and 3.81 times book value. The company isn't cheap. Investor confidence in management's ability to deliver is virtually non-existent. As such, the company should not be priced as a high-growth company.

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