Warning: Stay Away From These 2 Retail Stocks

Description

Recent quarterly results from **Dollarama Inc**. (TSX:DOL) and **Roots Inc**. (TSX:ROOT) have been disastrous, below expectations and increasingly showing cracks in their businesses and their outlooks.

Here is what investors should keep in mind as they think about these retail stocks now and in the future, as we can all learn lessons in situations like these and come out better investors for it.

Dollarama

With its second and now third quarter fiscal 2019 sales falling short of expectations, Dollarama stock has been hit hard, falling 20% on the day of the second quarter report, and more than 15% the morning of the third quarter release.

Dollarama stock is now down almost 40% year-to-date, as earnings expectations have come down, reflecting a slowing environment.

Before its downfall, Dollarama stock had been very richly valued, as investors had come to expect strong increases in sales, and recent same store sales growth of 2.6% in the second quarter and 3.1% in the third quarter are not numbers that would warrant such rich valuations.

Furthermore, in the last few years, Dollarama has gradually increased its price point on certain products. While successful, the company is now seeing pressure on traffic and the number of transactions and so has made the decision to minimize price increases, thus hitting margins.

There's definitely a trade-off here.

Third-quarter earnings came in slightly below expectations, and it appears that future earnings estimates may be too high given this new environment.

At a time of a weakening consumer, rising interest rates, and a consumer at risk, a retailer is not the best stock to be invested in, especially one that still trades at 24 times earnings.

Roots

In another story that has seen overly optimistic, earnings estimates come down dramatically, Roots stock has been hit hard, trading well below its IPO price of $12.00 — more than 70% lower in fact.

I don't 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 and now third quarter results that have come in below expectations, the future is unclear.

Same-store sales growth of 1.1% in the second quarter and negative 3.4% in the third quarter clearly shows us that this story has not played out as investment analysts had forecasted at the time of the IPO.

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.

In summary, the lesson here is that we should all remember that the retail industry is a very cyclical one , highly competitive, and very fickle, subject to fads that can come and go rapidly.

Valuation on Roots stock is looking more attractive, but with EPS estimates calling for 2021 EPS to be flat with 2018, we need to see growth coming back.

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2. TSX:ROOT (Roots Corporation)

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