Roots Corp. (TSX:ROOT) Stock Jumps 16%: Time to Buy?

Description

Roots (TSX:ROOT) jumped 16% February 4 to close at $4.19, its highest point since December. Still worth a fraction of its $12 IPO price, investors are probably wondering whether ROOT stock is a momentum play at this point.

Here are my two cents on the subject.

It's worth a flyer

Although there hasn't been any recent news about the company, value investors jumped in February 4, trading almost 800,000 shares, the highest daily volume in the past few months.

What could be the reason for so many shares trading hands in the dead of winter? It can't be anything related to the expiration of the lock-up period from its IPO. That occurred last April.

One possibility, although I have no proof and am merely speculating, is that Prem Watsa is buying a significant stake. **Fairfax Financial** has interests in many different retail businesses, including Sporting Life, Golf Town, Toys "R" Us Canada, William Ashley, and others. Prem Watsa is a value investor; Roots is a value stock.

It wouldn't be the craziest rumour on Bay Street. It's still an iconic Canadian brand.

Roots doesn't release its fourth-quarter results until April. They're not expected to be good.

In early December, the company reported terrible third-quarter results as well as lower guidance for fiscal 2019. It failed to give too many details of its expectations for Q4 2018 other than to say traffic and same-store sales strengthened for both Black Friday and Cyber Monday in the days leading up to the delivery of its third-quarter results.

Perhaps this is a case of investors buying on the rumour (better-than-expected Q4 earnings), and they'll be selling on the news come April.

What I do know is that this time last year, Roots stock was trading around $11.50, more than double where it's selling today. As speculative plays go, Roots is a good one. I just wouldn't put it in your RRSP or TFSA.

It's not worth the risk

Through the first nine months of fiscal 2018, Roots had an operating loss of $4.9 million compared to a profit of $243,000 a year earlier. In Q4 2017, it had an operating income of $29.9 million, 15% higher than fiscal 2016's fourth quarter.

The chances are good that the Q4 2018 operating profit will be a lot closer to 2016's result than 2017's. Let's split the difference and assume it delivers an operating income of $27.9 million. That would result in a full-year operating profit of $23 million in fiscal 2018 — a 24% drop from 2017.

That's a significant decline.

Fool contributor Ambrose O'Callaghan was concerned about the company's Q2 2018 profits in October. The third-quarter results likely didn't change his negative view of Roots stock. In fact, he'd recommended investors avoid it in the fall. It's dropped 23% since then despite the recent bounce.

Like I said above, Roots isn't a stock for your RRSP or TFSA — something I didn't think I'd be saying a year ago. It needs to deliver a couple of good quarters before investors revisit its stock.

The verdict on Roots stock

My biggest concern with Roots is its U.S. expansion.

Very few Americans know about the brand except for movie stars and athletes who come to Toronto and Vancouver and are exposed to it. American retailers have a tough time competing in the U.S. That goes double for Canadian brands, no matter how iconic they are in the domestic market.

Unless you're prepared to lose your entire investment, I wouldn't buy Roots stock at this point.

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