Why Has BRP Inc (TSX:DOO)(USA) Fallen 40%?

Description

Under the hood, everything seems fine for **BRP Inc** (TSX:DOO)(NASDAQ:DOOO). In fact, things seem more than fine.

From 2015 to 2018, the company grew its presence in nearly every market in the world. Over that period, North American revenues were up 27%, while European sales popped 17%. Impressively, sales from Latin America and Asia grew by 35% and 51%, respectively.

Recently, that strength has continued. In the first half of fiscal 2019, EBITDA is up 47% while normalized earnings per diluted share increased a whopping 103%. In light of these statistics, it might surprise you that shares are down 40% over the past six months. The TSX average, meanwhile, has fallen by just 2%.

Why the mismatch in fundamentals versus stock price? Are shares a bargain following the slide?

It's all about this one factor

BRP Inc utterly dominates its two largest markets: snowmobiles and jetskis. Globally, the company has a 50% market share for snowmobiles. BRP Inc also holds a 55% global market share for jetskis, which the company lumps into the personal watercraft category.

While management has done a terrific job taking market share, growing in new markets, and increasing profitability, the share price is now largely a function of the underlying market. If people around the world are buying more snowmobiles and jetskis, BRP Inc will win. If spending is pressured, expect the same for the stock.

Investors have recently been spooked with concerns of slowing discretionary spending for products that are highly recreational. While the company often boasts about its product's utility, there's no doubt that these are luxury items sold mostly for fun.

In many developed markets, households have been cutting back on savings to maintain their consumption. If a recession hits, the luxury items that BRP Inc sells will be the first to go.

In September, some large investors bailed on the stock, potentially due to these concerns. Late last year, 8.7 million shares, owned by institutional investors including Bain Capital, were sold at a price of US$47 (around $60 Canadian). Those shares were sold at nearly peak prices. Remaining investors were left holding the bag.

New verticals won't be enough

BRP Inc management is doing all it can to continue its growth. New verticals, including Can-Am variants, are set to help quickly. From 2015 levels, sales in this category is set to double in 2019. Unfortunately, this category is exposed to the same spending risks as the rest of its products.

This year, the company should earn around $3.60 per share, meaning it trades at just 12 times forward earnings. That's an incredibly attractive entry point, but only if global growth continues.

For comparison, in both 2015 and 2016, BRP Inc's earnings averaged roughly $0.40 per share. At those levels, shares would trade at 40 times earnings, a far cry from its current valuation. Shares look like a bargain, but further downside is easily possible.

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