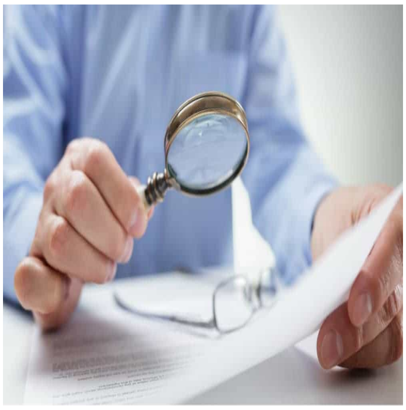

Avoid Retail Stocks? The Case Against Overexposure

Description

Overvalued and lacking momentum on the whole, have North American retail stocks lost their appeal? TSX index investors doing a bit of window shopping today might find little to grab their attention, with a mix of high P/E ratios and low expected earnings over the next few years. However, let's review the data and see whether any of the following stocks belong in a careful shopper's cart this week.

Roots (TSX:ROOT)

Down 8.87% in the last five days at the time of writing, Roots had (until now) been showing some improvement so far in 2019 after a steep May drop-off that seemed interminable. Roots' past year's earnings growth was negative by half a percentage point – fairly negligible, but not what a growth investor wants to see.

In terms of management – a metric of some import to an eagle-eyed investor – Roots' data shows a higher CEO remuneration than the average for Canadian interests of a similar size. Also, the average duration on the Roots board of directors is 1.4 years, lower than the three-year threshold suggestive of a seasoned tenure. Investors need to weigh whether this is a stock worth hanging onto in the hope of upside.

In summary, Roots has a fairly good balance sheet, though a debt level of 68.4% of net worth is on the high side; meanwhile, its market fundamentals are decent enough, with a P/E of 12.6 times earnings and P/B of 0.9 times book beating the overall market ratios.

Loblaw Companies (TSX:L)

Down 0.17% in the last five days, there's been little change in Loblaw's share price recently. It's been on something of a tear since October, but is this starting to level out? The five-year returns of 41.9% look good for this TSX index favourite, though this underperforms the Canadian consumer retailing industry, which saw returns of 77.3% for the same period.

Though Loblaw Companies' one-year past earnings dropped by 44.7%, an overall five-year average past earnings growth of 29.2% is solid, especially for retail. Further, in terms of management, Loblaw Companies scores higher than Roots with a commensurate CEO remuneration, and management team and board of directors tenure averages within the normal range.

A mix of high and low figures just where you *don't* want them characterizes the data: A debt level of 73.9% of net worth is perhaps too high for a quality investor looking to hold for the long-term, while a P/E of 34.5 times earnings is also on the high end.

Is North American retail overvalued?

Is an overvalued stock with a low 2.6% expected annual growth in earnings worth holding for a dividend yield of 1.82%? Compare the stats for Loblaws Companies with something like **Walmart** (NYSE:WMT).

The Canadian counterpart beats Walmart on track record, with the latter stock seeing negative one- and five-year past earnings growth rates and even higher valuation, with a P/E of 42.9 times earnings and P/B of 3.9 times book.

Debt seems to be an issue with high-street retailers at the moment: Walmart carries 72.9% compared to its net worth. However, its dividend yield of 2.17% and 22.1% expected annual growth in earnings beat those of the Canadian stocks listed above, suggesting a sturdier economic outlook.

The bottom line

While not representative of the TSX index, Walmart insiders have, perhaps tellingly, only sold shares in the last three months, with the past year seeing fairly persistent inside selling as a whole. The takeaway here is that North American retail in general may not be seen as a safe investment at the moment, with only low-debt stocks with decent expected growth being worth the outlay.

CATEGORY

1. Dividend Stocks
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TICKERS GLOBAL

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2. TSX:L (Loblaw Companies Limited)
3. TSX:ROOT (Roots Corporation)

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