Here’s Why This High-Growth Stock Fell 50%

Description

Once part of **BRP** (TSX:DOO)(NASDAQ:DOOO) has experienced a mixed history since it was spun off.

From 2013 to 2016, BRP stock gained roughly 0%. From 2016 to 2018, shares quadrupled in value. Depending on which period you invested, you’re either incredibly pleased or dismayed.

Over the past six months, shares have fallen off a cliff, down nearly 50%. Are shares a bargain, or is BRP stock ready to disappoint again?

Don’t be tricked

Over the next 12 months, BRP is expected to earn around $3 per share, meaning the stock trades at less than 13 times forward earnings. The TSX Index trades at around 20 times forward earnings. If you think that makes BRP a relative bargain, think again.

BRP manufactures and sells what essentially are luxury goods. While management wants to convince investors that many of its products constitute work equipment, there’s little doubt that they’re mainly used for play.

BRP’s main products include all-terrain vehicles, personal watercraft, and snowmobiles. The company dominates these markets. For example, it holds a 50% global market share for snowmobiles and a 55% global market share for jetskis.

While BRP’s management team has increased its market share and profitability over the last few years, investors are concerned that demand for its products will soon turn soft. If a recession hits, it won’t be difficult for consumers to forego their next jetski or ATV purchase.

According to the latest conference call, management agrees with this assessment: “Obviously, we do not like where the stock is trading today. It’s been like the first six months. And so part of what’s driven added some dark clouds over economic slowdown but the dark clouds seem to be dissipating and we are not seeing any slowdown in the economy.”

That statement ended optimistically, but it outlined the risks well. Often, cheap stocks are cheap for a reason. If people buy fewer high-powered toys, BRP will suffer.

Is the downside priced in?

If management’s expectations come to pass, BRP stock is incredibly cheap. On a forward earnings basis, it trades at less than 11 times 2020 earnings and less than 10 times 2021 earnings.

Plus, on nearly every metric, this is a management team you can trust.

For example, in 2017, the company grew sales by 5%, while the industry actually contracted by 2%. 2018 brought another year of relative outperformance, with company sales growing by 11% versus industry growth of only 5%. 2019 should boost company sales by another 11% while the industry is expected to grow by only low single digits.

While this seems impressive, it’s not sustainable. BRP’s industry isn’t that attractive, with average sales growth of only a few percent per year. Growing faster than the market means the company is taking share from competitors, which can only last for so long.

In summary, BRP isn’t growing quickly because it’s in the right industry. Rather, it’s executing well within a lacklustre industry.

That advantage helped the company’s stock quadruple unexpectedly over the past few years, but it won’t save the company from a recession. BRP stock is now a bet on a single factor: the health of the global economy.

If current conditions continue, BRP stock will end up looking like a steal. Still, I prefer to invest in companies with more power over their own future. I’ll be passing on shares, but investors with an informed stance on the future of the global economy should take a closer look.

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Date
2025/08/25
Date Created
2019/03/31
Author
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