Canada Goose (TSX:GOOS) Stock Looks Ridiculous but it’s a Bargain

Description

Canada Goose Holdings (TSX:GOOS)(NYSE:GOOS) stock is on fire.

In 2017, shares traded at just $23 apiece. Over the next 24 months, the stock rose by 200% to $69.

After the run, Canada Goose stock now trades at a lofty 80 times earnings. That looks ridiculously overpriced, but if you dive deeper, this stock could actually be fairly cheap.

Here’s how Canada Goose stock could be a bargain, even if the market makes it look expensive.

It’s all about growth

The current valuation of the TSX overall is something like 22 times earnings. That’s towards the higher end of its historical range. At 80 times earnings, Canada Goose appears aggressively priced.

The reason for the valuation disparity is the difference in expected growth.

The Canadian economy is only anticipated to grow at an annual rate of 2% over the next five years. Canada Goose, meanwhile, is expected to grow earnings by 32.5% per year over the same period.

Paying 80 times earnings for that kind of growth could be worth it.

This year, analysts forecast Canada Goose to earn $1.30 per share. If the company sustains a 32.5% annual growth rate, EPS would hit $5.31 by 2024. At today’s share price, that would mean the stock would trade at just 13 times earnings.

Is Canada Goose a buy?

If the growth rates above become a reality, Canada Goose stock would be a bargain for long-term investors. Over a decade or more, the company's market cap could easily exceed $30 billion, up from $7.6 billion today.

But how likely are those growth rates?

Most of the growth should be fueled by higher revenues versus increased margins.

Already, the company has done a commendable job improving profitability, but it's not clear how much it can continue to rely on higher margins.

In 2019, gross margins have clocked in at roughly 60%, up from 40% in 2015. **VF Corp** — a more mature competitor that owns venerable brands like The North Face, Timberland, and Smartwool — has gross margins of just 50%.

While improved margins likely won't factor much into EPS growth, there should be plenty of room for expanding the top line.

Management is currently guiding for annual revenue growth in the mid to upper 30% range. This target seems reasonable but comes with a large risk.

As I wrote previously, growth should come from international expansion. "More than 50 out of every 1,000 Canadians already own a Canada Goose jacket. In U.S. and China, by comparison, penetration is 90% lower," I said.

If Canada can replicate its domestic penetration rate across other countries, sales would have upside of 500% or more.

The biggest opportunity lies in Asia, particularly in countries with sizable middle and upper classes like South Korea, Japan, and China. The company's biggest opportunity, however, is also its biggest point of weakness.

With trade wars roiling global markets, Canada Goose faces growing headwinds as an exporter.

Canada in particular has shown a propensity to stand up against countries it disagrees with, as is the case with Saudi Arabia. With the U.S. and China embroiled in a multi-year trade spat, Canada and its exporters may eventually get pulled into the fire.

That, for now, seems like the only risk worth talking about. From branding power and repeat sales rates to ramping margins and sales growth, Canada Goose is hitting on all cylinders.

Apart from any exogenous trade risks, Canada Goose stock actually looks fairly cheap.

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