Why Did Canada Goose (TSX:GOOS) Stock Fall 32% on Wednesday?

Description

Emerging premium apparel giant **Canada Goose Holdings** (TSX:GOOS)(NYSE:GOOS) stock plunged as much as 31.8% on Wednesday to touch a day low of $45.42 per share on the **TSX** as traders and algorithms bid the retailer's share price lower, even after an impressive revenue growth spree. Why was investor sentiment seemingly irrational after earnings?

Total revenue growth of 4.5% for the fiscal year was indeed an impressive achievement for the growth stock, and so was the 62% growth in adjusted diluted net income per share to $1.36 and a spectacular 240 basis point increase in the adjusted EBITDA margin to 27.6%.

The GOOS has been increasingly profitable, and its shares commanded very high valuation premiums before the earnings release.

So what has really changed now?

Could it be a weaker management guidance?

Management issued a fiscal 2020 and long-term outlook for an annual revenue growth rate of *at least* 20%, an adjusted EBIT margin expansion of at least 40 basis points for the new financial year and a three-year average annual growth in adjusted net income per diluted share of 25% year on year.

Actually, this was almost the same long-term guidance that management gave during the past year, save for the adjusted EBITDA guidance, which has now been replaced by an adjusted EBIT guidance as the company adopts a new accounting standard IFRS 16.

Given the prior guidance for the recently reported financial year, the company pulled off a 40.5% top line growth,(double the 20% guidance), grew adjusted EBITDA by 240 basis points (better than the 50 basis point target) and annual adjusted income growth at 62% was far higher than the *at least* 25% growth guidance.

It may therefore be true that it wasn't the weaker guidance to blame, as such a guidance has been beaten before, but there could be a devil that lies somewhere in the financial results.

A look at the fourth-quarter performance

During the first three months of 2019, the company recorded a quarterly revenue growth of 25.2% over the comparable quarter last year. While this is still a commendable growth rate, sales for the same quarter in 2018 had grown by 144% over comparable 2017 figures. Perhaps the growth rate is slowing down and may have already fallen to within the company's long-term guidance.

Although the quarterly gross margin expanded to 65.6% from 62.7%, selling, general and administrative expenses (SG&A), are a very critical operating expense group component, grew from 48.8% of revenue to 54.4% of quarterly revenue and as such, the company's operating margin shrank to just 7.5% from nearly 12% in a comparable quarter in 2018.

I like making comparisons based on adjusted or normalized figures that plug out one-time gains or losses, and the company's adjusted EBIT and adjusted EBITDA figures for the recent quarter showed a worrisome trend.

While the adjusted EBITDA margin contracted to 13.1% from 17.4% in the fourth quarter, the adjusted EBIT, an operating profitability measure that the company will rely upon going forward, shrank to 8.3% from 13.5% of revenue in a comparable quarter in 2018.

One hopes that the recent quarter's trend of shrinking operating margins will reverse during the year, though it may be prudent for the market to adjust the valuation multiples attached to the stock if the new margins may persist at lower levels.

Foolish bottom line

Canada Goose Holdings' revenue growth has been propelled by new store openings as the company expanded into a high margin direct to consumer retail model from a predominantly wholesale strategy and entered new geographical markets, including China, while some strategic product price increases have seen margins expanding too.

However, the rate of new store openings could slow going forward, while price increases will definitely not persist. Investors may be justified to adjust for the potentially lower growth rate in future revenues and earnings, especially given the threat of weaker consumer demand growth as Canadians battle record high household debt that's threatening the retail sector.

That said, a 30% drop in one trading day may have been overdone, and I wouldn't be surprised to see a rebound in the share price over the coming weeks. Holding one's position in the stock could therefore be a wise decision.

The company is still growing its diluted earnings per share anyway, and management has announced a share repurchase program that may reduce outstanding subordinated share count by 2.7% within the next 12 months, boosting per share pricing metrics going forward.

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