Canada Goose (TSX:GOOS): Recent Drop Creates a Great Buying Opportunity for Long-Term Investors

Description

Canada's high-end apparel manufacturer **Canada Goose** (TSX:GOOS)(NYSE:GOOS) was slammed hard in May, sending shares down by more than 30%. The sudden decline was attributed to management's reduced revenue-growth guidance to 20% per year. Although revenue only increased by 25% in Q4, the lowest of the previous eight quarters, the stock is overly punished. I believe the risks around its revenue growth are too pessimistic and the current share price ($53) creates an attractive buying opportunity.

Revenue estimates are too conservative

Management was very conservative in its 2017 and 2018 revenue-growth estimates, where revenue growth was around 40% versus management's 20% guidance. Based on this, I believe 40% revenue growth in 2020 could be highly probable based on management's recent initiatives.

Canada Goose is slowly shifting its channels of distribution from wholesale to direct to consumer (DTC). DTC is a higher-margin segment, as it saves the higher mark-ups added by the middlemen and protects brand image. Selling directly to customers not only allows for a better relationship but also takes advantage of impulse buys, while gaining access to customer shopping data.

GOOS is expected to launch eight new retail stores in Italy, the U.S., Canada, China, and one brand-new digital concept store in Toronto. The firm is also releasing stores with a "cold room," which improves customer shopping experience by allowing them to try the products in the environment for which they are built.

The company had produced 47% of its down-filled jackets in-house instead of outsourcing them tothird-party manufacturers. Canada Goose also opened eight manufacturing facilities recently. In-house production not only adds value through increased profits and productivity but also improves scale production, efficiency, flexibility, quality, and product categories. This shows an improvisation of vertical integration, which should accompany an increase in revenue.

Lastly, leveraging its well-known brand and product quality, GOOS has significant pricing power, which is evident with its jackets ranging between $400 and $1,600, while the company's products go on sale very occasionally. Also, collaboration with actors should further improve its brand image and increase pricing power.

Risk/reward scenario

Bull case: Assuming a 2020 EBIT (earnings before interest and taxes) of $290.7 million, which is essentially a 40% increase in the revenue-growth rate, and a 35 times EV (enterprise value)/EBIT multiple) that is well below its 2018 multiple of 45 times EV/EBITDA, you would get a total enterprise value (TEV) of $9.15 billion (35 times $290.7 million). By simply adding back current cash value of $88.6 to TEV, we get a market value of $9.24 billion. And dividing this with expected diluted shares outstanding of 112.4 million, we arrive at a price target of $82. Ultimately, this is 54% upside from the current price.

Base case: Using the same concept, this time a 20% revenue-growth rate (management's base-case scenario) gives us an EBIT of $227.3 million. The current 30 times EV/EBIT multiple attains a TEV of $6.82 billion. Adding cash back (for market value) and dividing shares outstanding (112.4 million) would give us a $62 price target, which is 20% upside from the current price.

Bear Case: Just like the above-mentioned scenarios, assuming a 10% revenue growth will produce an EBIT of $205.2 million. With a 25 times EV/EBIT multiple, adding cash back and dividing it with shares outstanding would leave the share price at $46, which is essentially a 12% decline.

This draconian scenario assumes a slowdown in Canadian economy due to oil price volatility, China's consumer spending and more softness in the U.S. economy could affect the company's revenue. According to Fool.ca writer David Jagielski, there are still some risks around Chinese boycott of Canada Goose jackets following the arrest of Huawei's CFO. These issues could affect the firm's bottom-line revenue.

Overall, although there are some macro risks that are going to affect revenue in the near term, I believe Canada Goose is a high-growth company with a lot of untapped market across China, the U.S., and Western Europe. Buying at the current price gives long-term investors a great risk/reward scenario and a high margin of safety; it is way below its intrinsic value.

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