Is Aritzia (TSX:ATZ) Stock Finally Undervalued Now?

Description

Warren Buffett famously said that investors should buy the stocks of great companies and hold them forever. At the Motley Fool, we take Buffett's advice to heart and believe in the power of a long-term perspective when it comes to investing.

Everyone likes to find a good, undervalued stock. During a market correction, even the shares of the best companies will tumble, giving brave investors a rare opportunity to purchase them at a discount. In many ways, the best value investors make their fortunes by buying the stocks of beaten-down but otherwise solid companies.

Aritzia

Case in point, consider **Aritzia** (TSX:ATZ). The clothing retailer's stock was up over 140% over the trailing five years but has declined -32% year to date. The retail industry has been hit particularly hard as a result of both COVID-19 and recent inflation/rising interest rates, which is curbing consumer spending.

Currently, Aritzia trades at $35.78 per share, significantly below its 52-week high of $60.64 and closer to its 52-week low of $28.70. The stock is also significantly more volatile than the overall market, with a beta of 1.74.

Valuation

Even with the recent correction, Aritzia still trades at an expensive valuation. With a forward price-to-equity ratio of 22.57, price-to-sales ratio of 2.92, and price-to-book ratio of 7.90, the stock still looks expensive.

Compared to peers in the retail sector, Aritzia trades at a similar enterprise value/EBITDA ratio, currently at 12.40. This implies that in comparison with competitors, Aritzia remains fairly valued.

Growth

Aritzia has shown some good growth recently that justify this high valuation. The company recently posted 113% year-over-year (YoY) quarterly earnings growth, with 66.10% YoY quarterly revenue growth. Management effectiveness remains good, with a 11.44% return on assets and 35.22% return on equity.

For a retailer, Aritzia's profitability is good but not fantastic. Currently, the operating margin sits at 15.71%, with a profit margin of 10.50%. The company has decent cash flow, with operating cash flow of $338 million in the trailing 12-month and total cash per share of $2.39 as of the most recent quarter.

The Foolish takeaway

Even factoring in the strong growth, Aritzia still looks overvalued. There is a tonne of potential for further downside, as rate hikes continue and if inflation does not abate. If the economy falls into a recession, consumers will curb spending even more, leading retailers like Aritzia to suffer from poor sales and reduced revenue. The stock will likely remain more volatile than the market for the foreseeable future. For me, Aritzia is not a buy right now.

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