3 Reasons to Avoid Aritzia Stock

Description

The S&P/TSX Composite Index has come crashing down in 2022 — it's down more than 12%. In contrast, **Aritzia** (TSX:ATZ) has seen its stock price pretty much hold steady. There are some good reasons for this, such as strong revenue growth. But as we head into continued inflationary times and increasing recessionary pressures, I'm seeing more and more reasons to avoid this stock.

Without further ado, here are the three reasons that Artizia's stock price is at risk and why you should avoid Aritzia stock.

Rising interest rates are making life more expensive

Interest rates in Canada have risen sharply in 2022. In fact, the Bank of Canada's overnight rate has increased a dramatic 300 basis points — from 0.25% in January to the current 3.25%. The goal of these interest rate hikes is to stop inflation. Ultimately, it will do the job. But rising interest rates will also impact economic growth and, surely, consumer discretionary spending.

As life gets more expensive, discretionary spending is one of the first to be cut back. As a luxury-branded retailer, Ariztia's revenue is especially at risk. The fact is that as the economic environment worsens, consumers will opt for the less-expensive options.

Aritzia's debt load

Clothing retailers are in a notoriously cyclical business. When the economy is in good shape, revenue soars. But on the flip side, when the economy sours, consumers rein in their spending at a shockingly rapid pace. On top of this, clothing retailers are very prone to getting caught up in fads and crazes — they can be "in" one day and totally shunned the next, with seemingly no warning.

Given this potential volatility of a retailer like Aritzia, it would be dangerous for it to have too much debt on its balance sheet. But this has not fazed Aritzia. Currently, its debt-to-total-market capitalization ratio is 47%. This means that the company's total capitalization is made up of almost 50% debt. While its interest coverage ratio is quite healthy right now, revenues can take a nosedive pretty quickly, and so this can also change pretty quickly.

The risks are present in the macro-economic environment — interest rates are rising. These are risks that threaten the likes of Aritzia.

Valuation

Everything I've mentioned so far might be okay if a retailer's stock price is reflecting all of these realities. Today, Aritzia's stock price is trading at shockingly high multiples, given what's in store for the Canadian economy. For example, mortgage rates are rising fast. Also, energy prices are still high. Finally, food has been hit by inflationary pressures. All of this is reducing consumer's wallet size. It's certainly leaving us with less disposable income after all our necessities are taken care of.

So, trading at a P/E multiple of 35 times, I see big risk for this consumer discretionary stock, ATZ. There can be no denying that Aritzia has been a solid performer. But as the company's revenue has grown so rapidly, we risk ignoring the real struggles ahead. Simply put, in an economic slowdown, spending will be cut — and cut dramatically.

Trading at such high multiples and high expectations, Aritzia stock is too much of a risk right now. I would therefore avoid it like the plague.

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