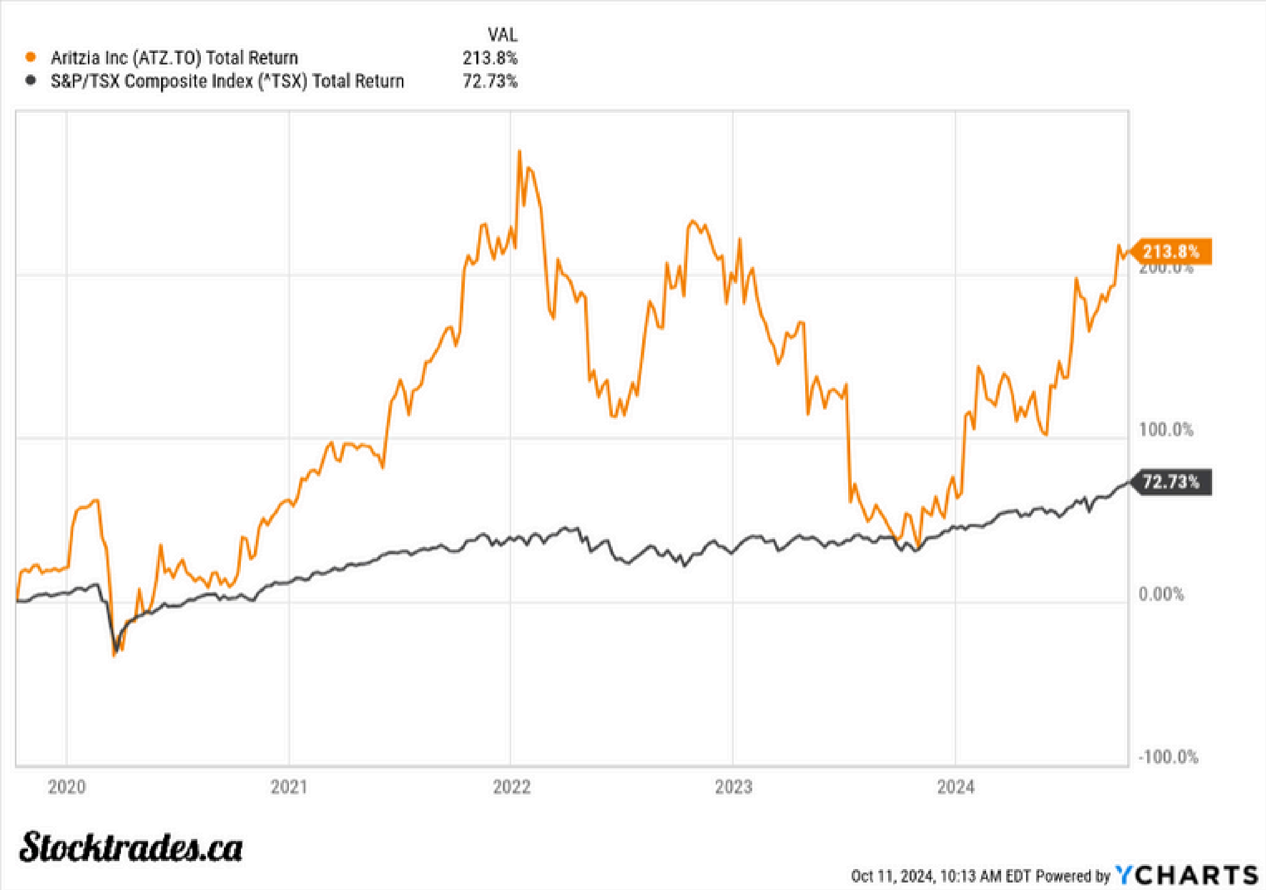
STOCKTRADES PREMIUM COMPANY SUMMARY

ARITZIA

ATZ.TO

OCTOBER 10, 2024

NOTE: DANIEL KENT OWNS ATZ.TO



Aritzia Inc is an integrated design house of exclusive fashion brands. It designs apparel and accessories for its collection of exclusive brands and sells them under the Aritzia banner. The category of products offered by the firm is blouses, t-shirts, pants, dresses, sweaters, jackets and coats, skirts, shorts, jumpsuits, and accessories. Its geographical segments include Canada and the United States. The company generates most of its revenue from retail, followed by eCommerce.

Sector: Consumer Cyclical

Industry: Apparel Retail

Current Price: $47.48

Stock Type: Growth

Our Risk Rating*: Aggressive

1 Year Price Target: $56

*Our Risk Rating: Our opinion of the overall risk an investment presents. Can be shown as Defensive (DEF), Moderate (MOD), or Aggressive (AGG). By no means is this an indication of future potential gains or lower volatility.

PROS

- Rapid US expansion efforts paying off
- Profitable company with high returns on capital
- Retail exposure is situated in North America
- The company is a mid-tier clothing company - which even in the midst of macro-economic difficulty should be able to withstand hardship better
- The company has high institutional and insider ownership
- Cheaper than competitors such as Lululemon and Canada Goose
- Inventory issues are all but resolved and markdowns are not as frequent
- The company's US growth is returning, and more than making up for weakness in its Canadian segment

CONS

- The retail industry is fickle. The strength is in the brand, and brand power can fluctuate quickly
- No guarantee that margins won't further compress due to headwinds
- The retail industry is cutthroat competitive
- The bulk of the company's growth is situated in the United States
- Sticky inflation and the threat of a recession is hampering growth and margins
- A large scale reduction in guidance was issued during the first quarter of 2023
- Softening consumer demand remains a headwind
- Because of its strong results in 2024, the value gap has been erased, and the company is now what I would call fairly valued

OVERALL THESIS

The backbone of a successful retail company is its brand. A few other Canadian companies that have executed with a large degree of success would be Lululemon and Canada Goose. We feel Aritzia's exposure to growth in North America versus Canada Goose's exposure to growth primarily being situated in China gives Aritzia a massive advantage. The fact the company executed so well amid a global pandemic gives us a high degree of confidence that the company can do so moving forward, even in the current economic environment.

The company's rapid growth in regard to both boutiques and e-commerce showcases its ability to grow with an omnichannel approach and appeal to a wider base of customers. The company's target market is primarily women, but it is beginning to expand into men's fashion which is, in our opinion, an untapped vertical for growth. Retail growth for the company is slowing; however, it is being more than made up for with a strong surge in e-commerce growth. This high-quality retail company is in its infancy, and although there will no doubt be bumps in the road like its current inventory issues, it already has a dominant market share in Canada and is beginning to expand in the United States rapidly.

If it does establish itself as a high-profile retailer in the United States, considering the population is 10 times that of Canada, growth has the potential to be exponential. The company's position as an affordable luxury retailer has it better positioned to outperform regardless of the economic circumstances. Many investors are bearish on the resignation of CEO Brian Hill, but the appointment of Jennifer Wong, who has emerged from an Aritza salesperson in the late 1980s to now CEO of the company in 2022, is a bullish sign in our eyes. Climbing through the ranks over a period of 3 decades shows how savvy of a businesswoman she is, and we have no doubt she'll be able to execute. It is not an outlandish thought to think this company carves out a similar path to wildly popular Canadian retailer Lululemon. LULU was Aritzia's size in terms of market cap in December of 2010. Fast forward 12 years later, and it has grown ten times the size.

POTENTIAL RISKS

The retail industry is extremely competitive. Although Aritzia is gaining market share at a pretty rapid clip right now, it can certainly change, and fast. Canada Goose had a similar growth trajectory but was impacted severely by two things. For one, its growth was primarily situated in China, and the pandemic impacted sales materially. But secondly, the company's ethical treatment of animals was questioned, which was damaging to the brand.

Aritzia is in a different position in terms of geographical growth and product lines, but the example was used primarily to express how fickle the retail industry is, and how negative perception of a company's brand, regardless of the quality of the product, can impact sales significantly.

Beta	**1.84**
Alpha	**5.9**
Our Risk Rating	**Agg***
Max Drawdown	**64%**

Input costs are always a concern with a retail company as well, as rising material costs can cause margins to compress and ultimately erode bottom-line growth. We are witnessing this right now with Aritzia. In combination with input costs, it’s also saw margins decline due to heightened expenses because of inventory buildup.

The company will need to be prudent with outsourcing materials and maintaining inventories to reduce risk. The company is witnessing a significant amount of growth in the United States, so much so that it now makes up the majority of its revenue. As a result, it is exposed to currency fluctuation, primarily the US Dollar. And much like we mentioned above, brand perception is huge in the retail space.

The retail industry faces significant ESG (environmental, social, and governance) issues, and these can have a material impact on a company much as it did regarding Canada Goose.

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Finally, high rates could impact the company's ability to meet growth targets. As a company that is rapidly expanding, there are costs associated. Costs that get higher when borrowing costs rise. One big risk with a company like Aritzia is that its economic moat is slim, due to the aggressive, competitive nature of the retail space. For this reason, it gets an "Aggressive" risk rating from us.

VALUATION

	TTM	5 Year Average	Industry Average
P/E	69.8	36.2	20.45
P/S	2.27	2.44	3.1
P/B	6.37	7.49	7.55
P/FCF	37.6	N/A	24.7
PEG Ratio (FWD)	0.218	N/A	N/A

To give you an idea of the volatility here, analysts are consistently making significant revisions down and up depending on the outcome of the quarter. For example, after a rough 2023, many analysts downgraded the company and, along with it, reduced earnings estimates. This was expected as the company reduced Fiscal 2023 guidance in a big way.

This led to the company's PEG ratio rising from 0.57 to 1.06, and all of a sudden, Aritzia didn't look as cheap from a growth perspective as it once was. Fast forward to now, and many of these same analysts have upgraded the stock and revised their estimates upwards. Now, Aritzia's PEG ratio stands at an attractive 0.218.

As we know, a ratio of under 1 is generally considered undervalued, while a ratio over 1 equals fair to overvalued. We're highlighting this to show the importance of not relying too much on forward-looking analyst estimates and instead making your own predictions about company growth. There is so much volatility in analysts' estimates that it makes relying on the PEG ratio a tough one.

While the valuation gap has certainly narrowed, we still believe Artizia is fairly valued. At just 19.5x forward earnings, the company still offers relatively strong rewards compared to the risks, particularly for those long-term investors that can sift out the noise.

Growth is still accelerating in the United States, and in our opinion, it is premature to be talking about a brand fallout. The macro environment is challenging, and consumer demand is undoubtedly softening. However, for those who look past these short-term headwinds, the future still looks bright for Aritzia.

COMPETITOR ANALYSIS

	ATZ.TO	GOOS	LULU
P/E	68.69	27.7	21.4
P/S	2.2	1.2	3.49
P/B	6.37	4.5	8.4
P/FCF	37	9	20.5

The closest publicly traded competitor Aritzia has is Lululemon. In terms of Canadian retailers, although it sells higher-priced items, Canada Goose is a reasonable comparison. When comparing these companies, Aritzia has the largest growth rates out of the 3. Although on the surface, Canada Goose looks cheaper now, it is going through some substantial issues in terms of operations and demand. We'd much rather pay elevated valuations for a company like Aritzia. Regarding Lululemon, this is a company that has always commanded a higher valuation than Aritzia. However, it is currently going through some operational hardships and as a result it has witnessed a large drawdown in price, similar to what Aritzia went through in 2022. At this point in time, we'd view both Aritzia and Lululemon as attractively valued.

Another note: Aritzia's price to earnings ratio looks quite high. However, this is due to some earnings hardships in 2023 that the company is not expected to experience in 2024. Remember, for the most part, the market prices a company on forward earnings, not trailing.

RECENT EARNINGS

Earnings Estimates	2025	2026	2027
EPS	$1.74	$2.43	$2.99
Revenue	$2.58B	$2.98B	$3.33B
EBITDA	$433.4M	$568M	$643M
EBITDA Margins	16.75%	19%	19.2%

Aritzia continues to post strong quarterly results, with beats on both the top and bottom lines. Revenue of $615M topped expectations of $584M, and earnings per share of $0.21 beat estimates of $0.1495 in a big way.

The company's US growth is returning in a big way, which is likely to be a significant tailwind for the company moving forward. US revenue grew by 23.9% year-over-year and now makes up 56% of the company's total revenue.

If you've been a member long enough to go back to when we first added Aritzia to the Bull List, this US revenue figure was in the mid-40% range, highlighting how fast it is growing in the United States, a market that is 10X the size of Canada.

Margins still have a ways to go to get back up to pandemic levels. Still, there has been a notable improvement over the last year, with gross margins increasing 5%~ year over year and finally breaking the 40% mark again.

The company now generates nearly a third of its business through online sales, highlighting the permanent shift to online ordering that I've spoken about many times before.

Operationally, the results were fantastic, and the long-term thesis remains well in place for Aritzia. However, the company faced some post-earnings selloffs, likely related to the guidance.

One thing I will say outside of the guidance, however, is the fact that selloffs like this are nothing to be concerned about, especially when the stock has gone on a run. It is easy for us to fret over a 5% dip while ignoring the fact that the company is up 82% on the year. We must learn to ignore the ebbs and flows of the market and let short-term traders dictate short-term prices while we accumulate shares of strong companies for the long term.

The company issued guidance expecting revenue to come in at $2.54B-$2.6B. This is technically a "downgrade" in guidance, because its previous high-end outlook was for $2.62B. I consider this borderline immaterial, as this is a 0.7%~ downgrade to the top end of its guidance. This represents 9%-11% growth on a year-over-year basis, a number I am perfectly fine with considering the environment.

This is a mid-tier fashion company that could easily be cut out of many consumer budgets in times like this. However, it continues to excel and grow earnings and revenue at a near double-digit pace. When rates decline, consumer spending increases, and the economy picks up. I believe Aritzia can get back to consistent double-digit levels of growth and cash flow generation.

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