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4 Stocks Caught In The Athleisure Trend

"I've already got one," said the knight when asked to go on a quest seeking the Holy Grail. "What? He's already got one?" How absurd!

What happens when everyone has "already got one." Is this the fate of the Athleisure trend? Everyone is already in on it. There's no one left to join the trend. So, it peaks and begins to die?

Are sports companies such as Foot Locker, Under Armour, Nike, Adidas and Lululemon part of the trend? Or will they exist no matter how the trend goes?

UA has had difficulties for the past 14 months. Last year, in 2016 the stock market declined in Jan/Feb and UA declined with it. However, when the market bounced back in March 2016, UA had some key executive departures which was considered bad news. Thus, UA did not recover like other stocks. In addition, the closing and bankruptcy of Sports Authority (a major sales retail outlet for UA) hurt UA sales for a period of time. UA continued throughout 2016 making great strides in its underlying sportswear products. Our take was that Kevin Plank is the driving force behind UA (similar to the way Steve Jobs was for Apple), and that as long as Kevin ran the ship, we wanted to be on board.

This year, UA slightly underperformed in Q1 and the stock took yet another hit. Underperformance on earnings and revenue were key for investors.

So, is the entire "athletic leisure" category dead?

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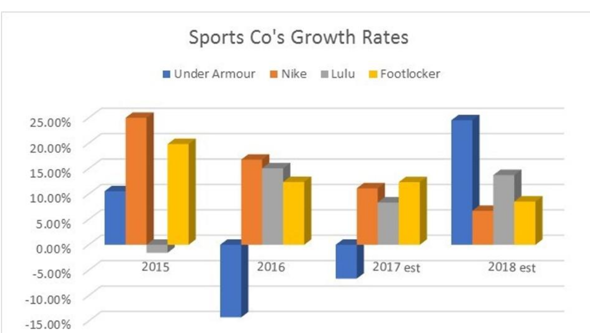
Foot Locker is still going strong, selling shoes from all three athletic companies – Adidas, Nike, and Under Armour. Lulu however, has certainly had their problems. Just as they were recovering from their see-through yoga pants debacle of 2013 which cost their CEO her job, they were hit again. This time the complaint was that they had the wrong “mix” of colors in their stores. The “mix” problem caused underperformance in sales and earnings. Athleisure may have hit its peak. But athletics may not have peaked.

Bottom line: even if “athleisure” has peaked, we don’t think that “sports companies” are dead. UA, Nike, and Adidas, are not really “leisure” – they are more of an expression of hard core sports by all levels of sports participants – not the same as Lulu, Athleta, Fabletics, and others. Sports companies like UA didn’t need athleisure to become great brands, and they won’t need athleisure in the future. But it’s worth noting that athleisure made it easier for UA, Nike, FL, and Adidas to grow faster.

If athleisure has peaked, growth may not be as easy in the future as it was in the past for all companies in this category. And the stocks have suffered. All retail in general has suffered, athletic leisure in particular. The graphic below is a culmination of earnings estimates on the growth rates of these companies:



Earnings Estimates on Growth Rates – Credit Warren Financial

Notice that UA's growth is expected to return. Nike's growth is slowing, however, perhaps that's expected given the law of large numbers and the overall size of the company. Lulu's growth is erratic, probably due to their unusual spate of problems. Finally, Footlocker's growth is also slowing.

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Companies sometimes have difficulties. Consider some widely-known difficulties in recent years. In 2010 British Petroleum, a true giant of a company, experienced the Deepwater Horizon oil spill from which they have yet to fully recover. Consider Chipotle Mexican Grill which suffered from a wide-spread outbreak of bacteria in 2015. Chipotle is yet to fully recover. Then there is the Lulu see-through yoga pants problem that tanked their shares.

However, in the process of recovery, sometimes a stock becomes a bargain buy. We have been buying Chipotle because customers are returning to their stores in droves. The financial ratios will not tell you the whole truth about when a company is beaten down, but becomes a buy.

As time passes, investors and customers begin to overlook mistakes from the past. This same pattern will play-out for Under Armour.

UA growth continues. Geographically, they are really in the beginning of expanding overseas and their overseas growth rate is 63%.

From a product segment point of view, their growth in footwear is astronomical at 50% year over year. Apparel was up 15%. Online sales for Under Armour make up 40+% of all product sales – a good sign.

Note that footwear and international are the growth drivers, but both have lower margin than the core apparel business in North America.

Bottom line: Athleisure may have peaked, but true sports companies will live on. UA will recover and go on to double again from a $5 billion business to a $10 billion business in the next few years. However, the stock will take time to recover, just as it will take time for the business to grow.

Note that UA split into UA(non-voting shares) and UAA (higher class, voting stock).

What to do if you own athleisure

Some investors may decide to "wait-it-out" in entirety. In the UA case, some investors may decide to sell off the second class of stock, the UA and hold onto the UAA. Our preference would be to just keep it all and let the growth of the fundamental business drive the stock higher in future years. However, as an investment advisor, we realize that, like any business, we need to make strong returns for investors. Under Armour has been hurting those returns. So, in some cases, we've chosen to dump the UA and invest in something else while we wait for the stock to recover (just as British Petroleum and Chipotle have taken time to recover). In some cases, we've decided to hang on to all the Under Armour stock.

Factors that should go into your decision making process include: (1) size of the position in the portfolio (2) how many years it has been held and what the long term gain tax implications would be if some Under Armour stock is sold (3) a consideration of long term gains/losses vs short term gains/losses and how they would offset in the portfolio (4) your particular investor risk tolerance (5) how the particular portfolio is impacted, and could be impacted by holding or selling (6) whether or not your holding is in an IRA or a taxable account.

If you are a long term Nike holder, you should probably continue to ride that large-cap into the sunset. Footlocker is probably a hold as well. Lulu may become a buy as they will benefit from smaller non-dominant athleisure startups going bankrupt and giving up. Continue monitoring Under Armour's progress and possibly buy more as the company recovers and the stock begins to recover with it. Footlocker is the picks and shovels of this category – in other words, they benefit no matter who makes the coolest shoes.

Under Armour is not a cheap stock. It never has been a cheap stock. That is because their growth rates are better than almost any other company. We expect that as they complete their infrastructure operational buildout (building towards the near-term goal of doubling in size again), that the great growth seen in the past will resume. If we don't see measurable progress, we will have to change course yet again.

It will take time. Stocks are not "mad money." Stocks make wealth. Stocks take time.

Disclosures*: Warren Financial has long positions in some of the stocks mentioned in this article (UA, UAA, FL, LULU) both for our clients and our own portfolios. We may be starting new long positions in some of these companies in the future. The fact that a company is mentioned is not a recommendation or offer to buy or sell that stock or bond. Investors should always seek advice from an advisor that knows their particular financial situation and not assume that general information such as the information in this article will apply directly to their portfolio. Investing includes the risk of loss.*

Randy Warren is CIO of Warren Financial. For more information on how to protect your investments from volatility visit WarrenFinancial.com and make sure to investigate our volatility strategies.