Is There Any Upside Left in Dollarama Inc. Shares?

Description

Yes, **Dollarama Inc.** (TSX:DOL) deserves a premium multiple due to its superior performance on a number of metrics, such as a 95% increase in revenue since 2013, and an industry-leading 21.8% operating margin, which compares to an operating margin of 2.5% at **Indigo Books and Music Inc.** (TSX:IDG), 13.9% at **Sleep Country Canada Holdings Inc.** (TSX:ZZZ), and operating losses over at **Hudson's Bay Co.** (TSX:HBC) and **Sears Canada Inc.** (TSX:SCC).

Same-store sales growth is 4.6%, which compares to most of its comparable group at below 2% and some operating at losses, namely Sears Canada and Hudson's Bay Co. However, two exceptions to this are Sleep Country and Indigo, which posted same-store sales growth of 10% and 4.1%, respectively.

Dollarama's shares have continued to strengthen and have returned an additional 37% in the last year after making great gains in the last few years. It is now trading at 33 times earnings compared to trading at almost 35 times earnings earlier in the year, as the company has continued to report better than expected results.

And although I have been of the opinion that the shares have been too richly valued for some time now, and I have therefore missed out on good upside, I still believe this decision was reasonable because I have kept in mind the reward potential versus the risk. And to me, the valuation of the stock places it in dangerous territory in terms of the risk.

There are also a few key metrics that I would like to point out in Dollarama's most recent quarter. Dollarama is seeing more merchandise selling at $2 and $3, which may start to change the value proposition for the consumer and increase competition.

Also, shoppers can now pay with credit cards at Dollarama, and the footprint to expand is still strong but is becoming more limited; some cannibalization is expected with future store openings.

And while same-store sales growth was a healthy 4.6%, this was below expectations, and with a stock that is priced for perfection, as Dollarama is, these ripples can cause investors to become skittish and put downward pressure on the stock.

Compare all this to Sleep Country and Indigo. Yes, they are both smaller, and Indigo is going after the more affluent consumer, so the business model is quite different, and Sleep Country is more specialized, but these stocks are trading at much more reasonable levels and have managed to post very healthy results.

In summary, in my view, Dollarama's valuations are too high, especially given that interest rates are on the rise and household debt has risen to unsustainable levels. No matter how high quality a company is, there is a point where investors begin to overpay for the shares, and it seems that this is happening at this time.

It's all about risk versus reward.

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