Why Shares of Dollarama Inc. (TSX:DOL) May Be a Great Short

Description

After missing earnings expectations one week ago, investors are finally starting to figure out that they have been paying much too high a premium for shares of **Dollarama Inc.** (TSX:DOL). After riding an incredible wave of growth in both top-line revenues and same-store sales, the ambitious plan set out by management for "world domination," or at least Canadian domination, has started to slow as things have gotten more complicated.

For veteran investors, however, the story is one that has been seen before and is well known. As the dollar store giant has become extremely successful over time, many consumers have started to demand bigger locations in their neighborhoods along with a greater number of locations to shop at. Although this would seem like a fantastic approach, the challenge is the cannibalization of sales from the existing client base.

As 62 additional location opened (in comparison to last year), the company was only able to grow same-store sales by 4-5% — in line with inflation plus a percentage point. This shows a clear slowing of growth.

When we evaluate the share price, it must be noted that for every seller, there must be a buyer, and for every buyer, there must be a seller. The stock market is impacted by the supply and demand of investors willing to trade shares at a given price. At the current price of $151 per share, the company trades at no less than 32 times earnings. The major problem with this price point is there must be willing buyers. Why would any investor purchase shares of a company with slowing growth for more than 32 times earnings in an environment with rising interest rates?

Let's return to the success that brought in clients by the handful: competitors from south of the border have also taken notice. Over the past few years, more and more U.S. dollar chains have started to set up shop north of the 49th parallel in an effort to cash in on the increase in popularity of dollar stores. Competition will not get any better from here: it will become much more fierce!

For young investors who want to benchmark this security, it is important to realize the difference between this brick-and-mortar name versus other names that have a web presence only. As we are learning from companies such as **Shopify Inc**., online often translates to easier to scale quickly, which — in at least in some cases — justifies a very high multiple for a long time. Dollarama is no longer worthy of such a generous valuation.

As the industry continues to become more competitive, and same-store sales face headwinds, investors should only expect to make a profit from this name on the downside. The dividend yield is less than 0.50% at the current time. Why not give it a try?

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