Is Lululemon Athletica Inc. (NASDAQ:LULU) About to Pull a Downward Dog?

Description

It's a real shame that **Lululemon Athletica Inc.** (NASDAQ:LULU) decided to ditch the TSX a few years ago, citing low trading volumes as the primary reason for flying to an exchange down south.

Despite being a Canadian company, the only way Canadian investors can get a piece of Lululemon stock these days is to head on over to the NASDAQ exchange, which requires playing the forex game at a time when the loonie is anything but strong. Unfortunately for Canadians, swapping loonies for greenbacks can be pain inducing. So, there really hasn't been an incentive to make the jump over the past years, unless you were able to spot the re-emerging trend of "athleisure," which is a North American trend whereby gym wear is used beyond the confines of a gym or the like.

With Lululemon stock skyrocketing 120% over the past year, it's a tough pill to swallow for a lot of Canadians who would have considered owning shares had they been easily accessible on the TSX. After a tremendous rally though, will Lululemon be able to continue to stretch to new highs? Or will it snap back, exposing new entrants in the stock to major downside?

No Chip? No problem

Despite the exiting of Lulu's former CEO, Chip Wilson, the company hasn't missed a beat, as fellow Fool contributor Will Ashworth pointed out. Unfortunately for Chip, who thought his prized yoga pant brand "lost its way" against rivals, the trend of "athleisure" began to pick up traction again, which has sent the stock soaring.

Moving forward, Lululemon is geared to move away from quality-control and supply-chain hiccups, so it's probably safe to say we won't be hearing of another "see-through yoga pant" controversy any time soon. Moreover, with a long international growth runway and a strong e-commerce platform in place, it certainly appears that Lululemon's earnings can stretch even further from here.

Lululemon's growth prospects show tremendous promise, and the industry-leading gross margins, which average 53%, are incredibly attractive; however, today's valuations make me cringe in spite of firm's seemingly solid trajectory.

The stock trades at a 38.6 forward P/E, a 10.3 P/B, a 6.2 P/S, and 34.1 P/CF, all of which are higher than the company's five-year historical average multiples of 32.4, 7.9, 4.8, and 29.0, respectively. That's really expensive! These are valuations indicative of a high-flying tech stock, not a pair of stretchy pants!

And although Lululemon is poised for incredible growth over the next few years, one thing that really worries me is that the trend of athleisure may die at a whim. Next thing you know, sporting yoga pants to work may not be deemed as acceptable, and if that's the case, Lululemon may find that it'll be hard to expand to markets beyond the gym.

Moreover, the space is getting pretty crowded, and as rivals like Athleta step-up their "innovation" within the athletic apparel space, I find it hard to believe that Lululemon will be able to maintain its sky-high margins, even if the athleisure trend sticks around for longer.

Bottom line

Lululemon's direct-to-consumer approach is paying major dividends, and although the firm is firing on all cylinders without its founder at the helm, the stock is absurdly overvalued at these levels. Over the long term, the athleisure trend is likely to fade away in conjunction with Lululemon's gross margins. And with rising competition in the athletic market, I think the valuation and the risks are just way too high to justify placing a bet on Lululemon.

If you're an investor, it'd be a prudent decision to take profits off the table, because if you hold the position, it may end up being the downward dog.

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