TFSA Investors: An Overvalued Stock You May Want to Sell

Description

When it comes to your TFSA, you mustn't be afraid to take a profit off some of your frothier stocks. The capital gains you'll lock in within a TFSA are entirely free from taxation, so it's in your best interest to lock in gains on some of the names that have risen above and beyond to valuations that'd have a value investor cringe.

It's tough to part ways with your winners, and in many cases, it's in your best interest to hang onto your winners for years, if not decades at a time. But when it comes to names that have risen to multiples that no longer justify the fundamental story, it makes sense to trim at least half a position with the intention of buying back shares at better prices on a pullback.

One stock that's been roaring this year but may be positioned to surrender a big chunk of the gains is **Dollarama** (TSX:DOL). Back in late 2017 (and early 2018), before Dollarama shares plunged over 45% from peak to trough, I'd urged investors to sell the stock immediately, citing the stock's absurd overvaluation, rising competition, a deterioration of growth prospects, poorly timed share buybacks, and lack of meaningful catalysts as primary reasons why shares would suffer a "nasty plunge."

Fast forward to today, and the stock has mostly rebounded, with shares pole-vaulting over 60% off its late-December bottom.

The stock is now off just 11% from all-time highs, and although recent developments, such as the acquisition of a 50.1% stake in Latin American discount retailer Dollarcity, bode well for the company's long-term growth profile, the stock is back at nosebleed-level valuations at around 30 times trailing earnings, once again leaving little to no room for further disappointment.

Given the recent rotation into more defensive plays, it's not a mystery as to why the premium has returned to Dollarama, but with competition continuing to move into Dollarama's turf here in Canada, I'm not a fan the outlook nor the price of admission at these levels.

Both brick-and-mortar discount retailers (like Miniso) and digital competitors (**Amazon.com** with its cheap "Add-On" items) could take a growing slice of the Dollarama pie moving forward. While Dollarama still offers a terrific value proposition for its customers, management is going to need to go the extra mile to spruce up the in-store experience if it wishes to remain competitive in a rapidly changing Canadian discount store scene.

That means hiding the stacked cardboard boxes in the back and making store fronts prettier to be less of a deterrent to younger consumers who are all about the experiential factor.

While management could have a few tricks up its sleeves to re-ignite growth, I don't see the stock as a value play, even given the unrealistic assumption that Dollarama will continue posting double-digit percentage top- and bottom-line numbers.

The stock trades at 28.9 times cash flow and 4.5 times sales, both of which are slightly higher than the stock's five-year historical average multiples of 26.3 and 4.38, respectively.

In short, you're paying a significant premium for the defensive growth nature of the company. Should another quarter show signs of slower growth, I'd watch out, because shares could fall sharply once again — after such a fall is when I'd pounce.

Stay hungry. Stay Foolish.

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