Investors Beware: This Popular Canadian Growth Stock Is About to Get Disrupted

Description

Dollarama Inc. (TSX:DOL) has been an incredible brick-and-mortar retailer that has returned over 300% back to shareholders over the past five years.

There are many things to love about the low-cost recession-proof business; however, after a historic run, I think valuation has become extremely frothy, and with promising new entrants hungry to steal market share away from the dollar giant, now's as good a time as any to sell Dollarama stock and use the proceeds to go on a Dollarama shopping spree instead.

International competition stepping up to the plate

In a previous piece, I noted that the innovative international retailers have been making the move into the Canadian brick-and-mortar retail scene in hopes of stealing market share away from their less-compelling Canadian counterparts.

Most notably, Asian retailers like Uniqlo, Muji, Daiso and Miniso have been making a huge splash in select Canadian markets on the first leg of their respective expansions. To say that these Asian stores have been popular among Canadian consumers would be a vast understatement. They've drawn a remarkable amount of in-store traffic that would be enough to put your average Canadian retailer to shame.

Miniso, a Chinese low-cost retailer and variety store chain that's been leveraging a Japanese-influenced branding strategy, could well become a serious threat to Dollarama over the next five years and beyond as it gradually increases its Canadian footprint.

For those who have never been in a Miniso, the layout is minimalistic, with a cleaner layout than that of your typical Dollarama store. Unlike Dollarama, however, item prices aren't capped at $4 per se; however, many of the goods sold are very reasonably priced without sacrificing too much on the quality front.

When I first ventured into a Miniso, I didn't immediately think it was a dollar store, as many of the products on display looked of decent quality, which was most likely because Miniso has adopted a Japanese-influenced design and branding strategy.

Dollarama should be investing to adapt, not buying back its expensive shares

I'm not at all a fan of management's decision to repurchase its own shares (at expensive multiples) rather than reinvesting to further improve upon its customer experience at existing locations. Over the next decade, competition in the Canadian dollar store scene may be about to get a heck of a lot fiercer, with various Asian retailers setting up shop across the country.

If Dollarama maintains its cluttered store layout with cardboard boxes of items stacked on the ground, I suspect that Miniso (or Diaso) will have little problem stealing Dollarama's slice of the pie. In addition, innovative and exclusive offerings (like Miniso-branded toothpaste dispensers) may become increasingly important in attracting consumers away from competitors. Dollarama may wish to acquire innovative concepts in order to keep up and command higher margins on the low-cost items it sells.

Bottom line

Dollarama shares trade at a hefty premium at 25.5 times forward earnings. Given the potential for immense disruption with the entrance of international players like Miniso or Daiso (another Asian dollar store) into the Canadian low-cost goods space, I think investors would be wise to reduce their exposure to Dollarama, at least until shares correct to a more reasonable valuation.

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