Dollarama Inc. (TSX:DOL): When Will the Bleeding Stop?

Description

What a horrendous year for **Dollarama** (TSX:DOL), the long-time market darling that appears to be running out of steam after many years of incredible growth.

An overdue and unsurprising correction

At the start of the year, when the stock was hovering near all-time highs, I'd warned investors that the stock was severely overvalued; I slammed management for choosing to repurchase shares rather than reinvesting to improve upon its underwhelming in-store experience.

"Dollarama has been repurchasing a tonne of its own shares at a time of question valuation." I said back on January 3. "The company has been racking up a lot of free cash, but I believe the share repurchases aren't the best use of this cash, especially since shares are absurdly expensive according to most valuation metrics."

Dollarama is in the crosshairs of some pretty scary up-and-coming competitors (like Miniso), so if management isn't proactively building upon its moat to stave off the competition, Dollarama will be a sitting duck that'll see its top-line numbers take a hit. Such a slowdown would cause Dollarama stock to be slapped with a value multiple, rather than a rich growth one.

Indeed, this is what we witnessed after the company released its second-quarter results. Same-store sales growth (SSSG) numbers were clocked in at 2.6%, falling short of analyst expectations of 5.26% and the 6.1% in SSSG that was enjoyed during the same quarter a year prior. Management downgraded its growth expectations by 1.5%, and analysts were quick to downgrade the stock after most of the damage had already been done to shares. The stock tanked 17% in a single trading session, and at the time of writing, Dollarama stock is in bear market territory, down 28% from its January all-time high.

Why Dollarama still isn't a buy at $40

Nearly a third of Dollarama's value has been wiped out since late January, and although the stock seems like an intriguing buy-the-dip candidate, I'd urge investors to wait for a better price, because at 25.5 times trailing earnings the stock is still ridiculously expensive given the headwinds on the horizon.

While discount stores like Dollarama are relatively immune from **Amazon.com** and other e-commerce disruptors, the fact remains that the company was still vulnerable to other brick-and-mortar players just like it. And when it comes to physical in-store experiences, I think Dollarama has a heck of a lot of work to do.

Shoppers want great in-store experiences, not a cluttered mess with stacks of cardboard boxes left, right, and centre. Dollarama's discounted goods offer tremendous value to consumers, and loyal shoppers will keep coming back for that. As consumer income increases in conjunction with the strengthening economy, however, discount shoppers are going to head to “classier,” potentially more expensive-looking stores to pick up substitute goods that would have been cheaper if purchased at Dollarama.

Just have a look at Miniso, a discount store that’s been aggressively expanding in Canada. The layout of the store is squeaky clean. It’s essentially like an **Apple** store for dollar store items, and the crowds that are drawn in are remarkable. Dollarama, however, is a cluttered mess with little to no promising décor to draw in millennial consumers. The poor in-store experience, I believe, is stunting Dollarama’s growth numbers and is making it easier for competitors to steal its slice of the pie.

Until management sheds more light on how it’s going to preserve its market share and reignite SSSG numbers, I’d continue to avoid the stock, and think that another 25% decline is in the cards.

Foolish takeaway

I’ve been incredibly bearish on Dollarama over the past year. The stock was extremely expensive before the correction, and after the 28% plunge, shares still look overvalued given the rocky road that lies ahead. If you’re keen on the name, I’d wait for shares to fall to $30 before considering a position in a company that I believe has lost a step.

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