Dollarama Inc. (TSX:DOL): After a 30% Plunge, Is This Discount Retailer Trading at a Discount to its Intrinsic Value?

Description

Dollarama (TSX:DOL) is a Canadian growth darling that went sour this year after same-store sales growth (SSSG) numbers fell short of expectations, causing investors to reset their expectations on a name that was in dire need of a correction, as I'd emphasized in many prior pieces before Dollarama stock fell off a cliff.

I've been one of the biggest Dollarama bears here at the Motley Fool Canada over the past year, and my bear thesis has been twofold: the stock was ridiculously expensive because of unrealistic growth expectations, and the company was ill-prepared to adapt to a more challenging environment that was on the horizon.

Today, after the 30% correction, Dollarama seems to be trading more in line with what's realistic. The stock trades at a 18.1 forward P/E, which is substantially lower than the company's five-year historical average P/E of 28.9. Moreover, shares now have a 4.0 P/S, and a 23.0 P/CF, both of which are in line with the company's five-year historical average multiples of 3.9 and 26.9, respectively.

The stock appears pretty cheap from a historical standpoint, but when you consider the reset of expectations due to slowed growth that's up ahead, I'd argue that Dollarama stock isn't yet priced at a discount to its intrinsic value, especially when you consider the fact that management doesn't appear to be in good enough shape to compete against new entrants in a new age of brick-and-mortar retail.

Dollarama is still a king of delivering value to its customers. The sound relationship the company has with its suppliers allows the company to deliver attractive prices that are essentially unmatchable, and that's going to keep a majority of its customers coming back for more as long as the bargains are still present. The only thing holding Dollarama back, however, is management's reluctance to reinvest in the appearance and layout of existing locations.

Offering great value to customers isn't going to cut it anymore, as consumers, millennials in particular, gravitate towards more experiential retailers.

Let's face it. The experience of shopping at Dollarama isn't at all remarkable. Actually, it stinks with the outdated store layout, the clutter, and cardboard boxes stacked in random locations at most of the stores I've visited. I don't know if Dollarama is trying to deter millennials from coming in its stores, but if management doesn't revamp things, a more millennial-friendly discount retailer like Miniso could easily capture a big slice of the Canadian discount store market at Dollarama's expense.

Foolish takeaway

Now, I'm no interior designer, but if I think Dollarama really needs to hire a team of them if they wish to re-accelerate SSSG numbers in an era of increased competition.

If management commits to reinvest in the “in-store experience” instead of using cash to repurchase shares at a time of severe overvaluation, I’d have no problem recommending the stock. But until then, I’d encourage investors to look elsewhere, as Dollarama shares are fair-valued at best after its recent plunge.

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