This 2018 Dud Could Become the “it” Stock of 2019

Description

Dollarama (TSX:DOL) was one of the biggest losers of 2018 with shares falling a whopping 38% for the year. With shares now off 44% from peak levels, contrarians may want to consider picking up the dud now that the bar (and valuation) has been lowered substantially.

For many Foolish followers, Dollarama’s violent decline shouldn’t have come as a surprise.

Last year, I’d warned investors that the stock was severely overvalued and that management’s decision to repurchase shares would come back to haunt them. At the time, Dollarama shares traded at over 36 times trailing earnings, with what I thought were overly ambitious and incredibly unrealistic growth expectations baked into the stock in spite of a handful of concerns that I thought were apparent on many levels.

In November, I’d doubled-down on my bearish stance after short-sellers at Spruce Point Capital Management called an already battered Dollarama a “broken growth story” that could tumble by another 40%. I also shed light on the fact that **Amazon.com** had begun barging into Dollarama’s turf with its low-cost “add-on” items that were once thought of as uneconomical to sell via an e-commerce platform.

“Discount stores like Dollarama which were once thought of as Amazon-proof may not be as insulated as many investors may have thought a few years back.” I’d said in a prior piece. “Dollarama’s moat was its ability to command low prices, but with Amazon breathing down its neck with low-cost ‘add-on’ items, Dollarama’s margins will stand to be pressured, and its moat could easily erode because, as well all know, Amazon plays hardball when it comes to price undercutting.”

Add the entrance of other Canadian discount retailers (like Miniso) into the equation, and Dollarama still seemed expensive, even after the stock lost over 30% of its value.

What has me changing my stance all of a sudden?

Dollarama has fallen off a cliff, no doubt, but it’s still priced as a growth stock at 19.5 times trailing earnings (14.5 times next year’s expected earnings). Although the quarter that sent Dollarama off a cliff showed weakness across the board, marking the potential start of a sustained downtrend for comps, there's still hope for management to compete in a now more competitive environment.

Dollarama has over 1,000 stores across the country, and it's this deep country-wide penetration that serves as Dollarama's strength. As I've mentioned in prior pieces, management needs to roll up its sleeves and focus at the individual store level to bolster comps with "experiential" initiatives to draw in consumers.

You can have all the best deals in the world, but if you've got a cluttered mess of a store, you're going to deter folks from entering it, especially millennials, who are all about the experience factor. Dollarama's bargains are sexy, but its store layout? Not so much. Most millennials would be willing to pay up for a sexier in-store experience, rather than getting lost in the narrow, messy, and unorganized aisles at Dollarama.

I was a huge fan of management's decision to put its nose to the grindstone with its online store that's being piloted in the province of Quebec. It showed that management isn't willing to wait around for the macro picture to change and their willingness to put their nose to the grindstone to turn the "broken growth story" around.

As management continues to pursue comps-driving initiatives, I'd say that the stock could be close to a bottom with tremendous upside over the next year and beyond.

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