Why I'd Be Sick to My Stomach if I Owned Dollarama Inc. (TSX:DOL) Stock

Description

Dollarama (TSX:DOL) was one of the biggest TSX dogs of 2018 with shares plunging 43% from peak to trough after the company pulled the curtains on an abysmal quarter that revealed many disturbing trends that I warned investors of many months prior.

Indeed, Dollarama was a stock that Mr. Market got utterly wrong.

Everybody had sanguine growth expectations, so when top-line growth inevitably decelerated, the sell-off got violent, as investors fled the growth stock that appeared to be transforming a stalwart.

The mispricing in shares was pretty significant, but in spite of the apparent re-adjustment to growth expectations, the stock still trades at a hefty multiple at 23.2 times trailing earnings. Although the steep correction is now in the rear-view mirror, the current valuation implies that Dollarama is still capable of double-digit growth. Such ambitious growth expectations still appear unrealistic given the harsher competitive landscape in Canada's discount retail scene.

As a shareholder, if you didn't give enough merit to Dollarama's headwinds (many Main Street analysts didn't), which I thought was writing on the wall, you took a big loss that could have easily avoided with the unfavourable trends that were unfolding months prior to the quarter that kicked Dollarama off the podium and into the doghouse.

Most of the headwinds still apply to this day, and although Dollarama stock is cheaper in price, I'd say shares still aren't cheap enough given the dents in the armour we've witnessed and the lack of promising commentary from management to deal with the headwinds.

Another weak quarter for the books

Dollarama disappointed again for its Q4 fiscal 2019 numbers. Same-store sales growth, EPS, and EBITDA numbers fell short of analyst expectations, but despite the poor results, management still increased its dividend by 10%.

Talk about an unearned dividend hike.

While the dividend hike may be seen as a bright spot on an otherwise dark quarter, I wouldn't treat it as a sign that things will be bouncing back anytime soon. Things could get a lot worse over the medium term, as up-and-coming discount retailers like Miniso continue to expand their footprint in Canada's discount retail scene.

Add e-commerce concerns into the equation, and I'd say the dividend hike would have been better off going towards an investment either towards e-commerce efforts or towards the poor in-store experience, which I've slammed in many prior pieces.

Given Dollarama's prior decision to repurchase its own shares at a time of severe overvaluation, count me as not surprised to hear that management is using its cash to entice investors to prop up the stock in the near term. Now that the trajectory is negative, it's going to take a lot more than a dividend hike or share repurchases to get the stock back in the green. The only way to do this, I believe, is to invest heavily in initiatives (changing the store layout perhaps?) to reignite the same-store sales growth numbers.

Foolish takeaway

With the recent economic slowdown, you'd think that more consumers would be flocking towards Dollarama and its low-cost options. This hasn't been the case, as the company has continued to report disappointing key metrics, likely because of the company's reluctance to reinvent the in-store experience and the fact that competitors are now spreading their wings in Dollarama's air space.

Until we learn of any potential catalysts, I think Dollarama is heading a lot lower over the next year and would discourage dip-buying at these levels.

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