Danger: Why Dollarama Inc. (TSX:DOL) Is Destined to Be a Dud

Description

I've been one of **Dollarama** (TSX:DOL)'s harshest critics over the past few years. I've slammed the company over millennial-unfriendly in-store experience, its quickly eroding moat, and management's decision to repurchase its shares at a time of severe overvaluation.

Now that shares have suffered a huge fall from grace, it's easy to see the mistakes that were made. But for those who were sticking around before Dollarama's significant fall, there was an opportunity to jump ship, as the writing was on the wall many months prior to the quarter of slowed growth that caused shareholders to lose their shirts.

Fast-forward to today, and I'm still not happy with the value proposition or the trajectory of the company. While shares are no longer trading at over 30 P/E per share, the 23.9 trailing P/E is still rich and is full of growth assumptions that I believe investors shouldn't be making.

Dollarama is still in a tough spot. While management has made the e-commerce efforts to offset a portion of the digital pressures put forth by sellers of bulk discount goods, I still think there's a ton of work and investment to be done before Dollarama can get its comps back to where they were over a year ago.

Dollarama is a brick-and-mortar retailer first and foremost. And frankly, the in-store experience still stinks with the cardboard boxes piled up on the ground. The ugly store layout appears to be a huge deterrent for younger crowds despite the colossal value proposition that Dollarama is able to offer to its customers.

To make matters worse, Japanese discount retailers are continuing to spread their wings in the Canadian market. The Japanese economy has been jumping in and out of deflation for lengthy periods of time in the past such that the Japanese have adopted the mindset to better-equip themselves for such a deflationary environment.

When there’s deflation, goods prices and wages are either flat or down trending, which means 100 yen (around a buck CAD) today will be worth a heck of a lot more in a couple of years down the road, even with no interest paid by any banks.

The deflationary mindset adopted by many Japanese has involved a high degree of frugality and minimalism, with an intense, even extreme focus on saving money.

That’s why many intriguing and innovative discount retailers like Miniso have exploded in Japan. Now that they’re moving into the Canadian market, which has been dominated by Dollarama, the competitive landscape has changed permanently.

Not only do I think hungry competitors of Dollarama are capable of stealing share in the Canadian discount retail scene, but I believe they are better equipped to offer a better value proposition to customers. You see, Japanese companies like Miniso are not only able to offer terrific prices, but they’re also able to offer innovative, exclusive pieces of Japanese-designed merchandise.

With such Japanese retailers raising the bar in the Canadian market, Dollarama is going to need to seriously up its game or its comps are going to continue to suffer and the stock will keep plunging.

Based on what I’ve seen from stores like Miniso, I think it’ll be an uphill battle for Dollarama with regard to levelling the playing field.

Comps, sales, and gross margins will be under pressure, while capital expenditures can be expected to increase. All of a sudden, Canada’s discount retail scene is starting to look like the grocery scene. Razor-thin margins may be up ahead, so I’d steer clear of Dollarama at these valuations!

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