3 Reasons to Sell Dollarama (TSX:DOL) Stock Before it Heads South

Description

Dollarama (TSX:DOL) has done a remarkable job of thriving in the low-margin world that is discount retail. Unlike in the U.S., the Canadian dollar store scene isn't cut-throat competitive, with few players in the space that have the penetration or value proposition that can match up with Dollarama.

Indeed, Dollarama is a premium player in its niche with a dominant position in a defensive industry that'll be minimally impacted by an economic downturn. So, in these volatile times, it's not a mystery as to why Dollarama stock has been a Canadian market darling.

Dollarama has had a tremendous run over the years, though. And early last year, I rang the alarm bell on Dollarama, warning investors of the stock's severe overvaluation, the risk of a downward reset of expectations, rising competition in Canada's discount retail market, eroding margins, a sub-par in-store experience, and a poorly timed share repurchase program.

After my warning was published, Dollarama stock eventually took a 45% peak-to-trough plunge, before regaining most of the ground following some favourable developments, such as Dollarama's venture into the Latin American market with a partial stake in Dollar City, and a sudden pick-up in Dollarama's numbers.

While Dollarama stock looks poised to retest its all-time high levels, I'd urge investors to take caution, as many of the headwinds I shed light on nearly two years ago have yet to fade. Here are three reasons why it may be a smart idea to take profits at Dollarama before another big plunge.

Gross margins under pressure

The last quarter (Q2 of fiscal 2020) saw some pretty fantastic same-store sales numbers of nearly 5%. Unfortunately, gross margin dipped by 1.40% and lower-margin items were a likely reason why store traffic picked up for the quarter.

While the sales pick-up was nice, the erosion of gross margins was discouraging and appears to be evidence of more competitive forces that may soon challenge Dollarama's dominance in the Canadian discount store scene.

Premium price tag unjustified

At the time of writing, Dollarama trades at 28 times trailing earnings, and 21.1 times cash flow and 4.1 times sales (both trailing 12 months), all of which were on the high end compared to the discount retail industry average.

The premium price tag assumes that Dollarama is capable of continuing to post double-digit top- and bottom-line growth over the intermediate term. This may not be a realistic assumption to make given the competitive pressures in the domestic market and the operational risks involved with getting into the Latin American market.

Sure, Dollar City could inject new growth into Dollarama, but it shouldn’t be seen as the cure to Dollarama’s problems, as there is potential for things to go wrong.

Significant insider selling of late

Finally, insiders have been dumping their shares of late, with over $122 million in net selling activity over the last year. This week, CEO Neil Rossy did a bit of profit-taking, likely because he sees Dollarama stock as frothy and ripe for a pullback.

I think investors ought to follow in the footsteps of Dollarama’s insiders by taking at least a bit of profit off the table before the stock heads south in a hurry.

Stay hungry. Stay Foolish.

CATEGORY

1. Investing
2. Stocks for Beginners

TICKERS GLOBAL

1. TSX:DOL (Dollarama Inc.)

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

Category

1. Investing
2. Stocks for Beginners

Date
2025/07/28
Date Created
2019/10/08
Author
joefrenette