CAUTION: 3 Reasons Why Dollarama Stock Could Fall Further

### Description

**Dollarama** (TSX:DOL) reported its Q1 2021 results on June 10. The event attracted a mixed reaction from investors, as its stock initially rose by over 6% but ended the session with just 2.5% gains for the day. On a year-to-date basis, the stock is still hovering within the positive territory, with about 3.2% gains. In contrast, the **S&P/TSX Composite Index** has lost 9.3% in 2020.

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In my article on June 9, I'd pointed out that Dollarama stock could be an excellent long-term buy, but I'd suggested to avoid buying it at the current level. Since then, the stock has — largely — traded on a negative note. I still wouldn't rush to buy its stock, as I expect it to fall further in the near term. Let's find out why.

## Deeper dive in its recent financials

In the first quarter of fiscal 2021, Dollarama reported $0.27 EPS (earnings per share) — down 50.9% from $0.55 in the previous quarter. With this, the company just managed to beat analysts' EPS estimate of $0.26. It was also 18.2% worse than its first-quarter earnings of $0.33 per share in the previous fiscal year.

Dollarama's Q1 total revenue fell by 20.7% sequentially to $845 million. However, it showcased a 2.0% YoY (year-over-year) increase. Its gross margin — for the quarter — shrank by 0.8% YoY. The scaling effects of lower sales per store and a higher contribution of low-margin products in its total sales hurt the company's profitability.

As the economy continues to struggle with an increase in the unemployment rate, the contribution of low margin products in Dollarama's total sales could continue to rise — further hurting its profitability.

## What would affect Dollarama's future growth?

Despite closures and restrictions due to the ongoing pandemic, the company managed to open 10 net new stores in the last quarter. However, this figure was nowhere close to 66 new stores it opened in the previous quarter. This significant drop in its new store openings reflects how the pandemic has severely affected Dollarama's store expansion plans, which would certainly affect its sales growth rate in the near term.

The pandemic has forced it to reduce shift sizes capacity and focus more on health checks and sanitization measures. In the second half of the first quarter, these measures increased the company's direct costs by $15 million. I expect these incremental costs to continue taking a toll on the Canadian retail chain's profitability in the next few quarters, as the fears about COVID-19's second wave continue to haunt the world.

## Foolish takeaway

In its first-quarter earnings call, Dollarama's management highlighted that COVID-19's full negative impact is expected to be reflected in the company's second-quarter results.

I believe it would be wise to keep your hopes low regarding the company's results — at least — for the next couple of quarters. Its rising costs, shrinking profit margins, and a blow to its store expansion plans could be enough to hurt investors' sentiments. For these three seasons, I expect Dollarama stock to slip further in the short term.

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