Dollarama, Inc. | Toronto: DOL

INVESTMENT RESEARCH REPORT

"Hard To Bargain For A Higher Price"

RECOMMENDATION: *Strong Sell*

Full Legal Disclaimer

This research presentation expresses our research opinions. You should assume that as of the publication date of any presentation, report or letter, Spruce Point Capital Management LLC (possibly along with or through our members, partners, affiliates, employees, and/or consultants) along with our subscribers and clients has a short position in all stocks (and are long/short combinations of puts and calls on the stock) covered herein, including without limitation Dollarama Inc. ("DOL"), and therefore stand to realize significant gains in the event that the price of its stock declines. Following publication of any presentation, report or letter, we intend to continue transacting in the securities covered therein, and we may be long, short, or neutral at any time hereafter regardless of our initial recommendation. All expressions of opinion are subject to change without notice, and Spruce Point Capital Management does not undertake to update this report or any information contained herein. Spruce Point Capital Management, subscribers and/or consultants shall have no obligation to inform any investor or viewer of this report about their historical, current, and future trading activities.

This research presentation expresses our research opinions, which we have based upon interpretation of certain facts and observations, all of which are based upon publicly available information, and all of which are set out in this research presentation. Any investment involves substantial risks, including complete loss of capital. Any forecasts or estimates are for illustrative purpose only and should not be taken as limitations of the maximum possible loss or gain. Any information contained in this report may include forward looking statements, expectations, pro forma analyses, estimates, and projections. You should assume these types of statements, expectations, pro forma analyses, estimates, and projections may turn out to be incorrect for reasons beyond Spruce Point Capital Management LLC's control. This is not investment or accounting advice nor should it be construed as such. Use of Spruce Point Capital Management LLC's research is at your own risk. You should do your own research and due diligence, with assistance from professional financial, legal and tax experts, before making any investment decision with respect to securities covered herein. All figures assumed to be in Canadian Dollars, unless specified otherwise.

To the best of our ability and belief, as of the date hereof, all information contained herein is accurate and reliable and does not omit to state material facts necessary to make the statements herein not misleading, and all information has been obtained from public sources we believe to be accurate and reliable, and who are not insiders or connected persons of the stock covered herein or who may otherwise owe any fiduciary duty or duty of confidentiality to the issuer, or to any other person or entity that was breached by the transmission of information to Spruce Point Capital Management LLC. However, Spruce Point Capital Management LLC recognizes that there may be non-public information in the possession of DOL or other insiders of DOL that has not been publicly disclosed by DOL. Therefore, such information contained herein is presented "as is," without warranty of any kind – whether express or implied. Spruce Point Capital Management LLC makes no other representations, express or implied, as to the accuracy, timeliness, or completeness of any such information or with regard to the results to be obtained from its use. You should assume all statements made are our opinions, unless sourced as facts where practical.

This report's estimated fundamental value only represents a best efforts estimate of the potential fundamental valuation of a specific security, and is not expressed as, or implied as, assessments of the quality of a security, a summary of past performance, or an actionable investment strategy for an investor. This is not an offer to sell or a solicitation of an offer to Buy any security, nor shall any security be offered or sold to any person, in any jurisdiction in which such offer would be unlawful under the securities laws of such jurisdiction. Spruce Point Capital Management LLC is not registered as an investment advisor, broker/dealer, or accounting firm.

About Spruce Point Capital Management

Spruce Point believes that Dollarama is significantly overvalued based on its undifferentiated and increasingly uncompetitive business model, inflated and unsustainable margins which are posed to decline, and its limited growth prospects which will restrain its ability to hit its long-term earnings expectations.

Spruce Point Capital Is An Industry Recognized Research Activist Investment Firm Founded In 2009

- Founded by Ben Axler, a former investment banker with 18 years experience on Wall Street
- Ranked the #1 Short-Seller in the world by Sumzero after a comprehensive study of 12,000 analyst recommendations dating back to 2008 (March 2015)
- Ranked the #13 Most Influential FinTweeter on Twitter according to Sentieo analysis (Dec 2016)

CEO Departures Post Recent Spruce Point Research Activism

Report Date	Company / Ticker	Enterprise Value At Report Date ($ billions)	CEO Departure / Date
2/7/18	Realty Income / O	$19.8	John Case / Oct 2018
8/16/17	Dorman Products / DORM	$2.2	Mathias Barton / Aug 2018
7/13/17	Gentex / GNTX	$4.7	Fred Bauer / Jan 2018
4/13/16	Sabre Corp / SABR	$11.2	Tom Klein / June 2016
12/17/15	Intertain / IT.TO	$1.5	John FitzGerald / Feb 2016
8/19/15	Caesarstone / CSTE	$1.7	Yos Shiran / May 2016
2/10/15	Greif / GEF	$3.2	David Fischer / Oct 2015
11/13/14	AMETEK / AME	$14.0	Frank Hermance / May 2016
1/15/14	LKQ Corp / LKQ	$11.8	Robert Wagman / March 2017
7/23/13	Just Energy / JE.TO	$2.0	Ken Hartwick / Feb 2014
3/5/13	Boulder Brands / BDBD	$1.0	Stephen Hughes / June 2015
6/14/12	Bazaarvoice / BV	$1.2	Bret Hurt / Nov 2012

Spruce Point Has Succeeded In Canadian Shareholder Activism

Spruce Point has written four critical activist reports in Canada. In a majority of the cases, the share price has met or exceeded our downside estimate of intrinsic value. The average share price decline is 57%. A common theme is that Canadian analysts don't ask difficult questions of management, challenge assumptions, and are overly optimistic.

Company:	Intertain	TSO3	Just Energy	Maxar (Formerly MacDonald Dettwiller)
Exchange: Ticker	TSX: IT	TSX: TOS	NYSE and TSX: JE	NYSE and TSX: MAXR
Report Date	December 17, 2015	August 23, 2017	July 31, 2013	Aug 7, 2018
Stock Brokers Who Say Said "Buy"	Canaccord/Mackie/Nat'l Bank/Cormark	Canaccord/RBC/Scotia/GMP	Canaccord/RBC/TD/CIBC	Canaccord/RBC/TD/CIBC/GMP/BMO/ Nat'l Bank/Scotia
Spruce Point's Criticisms	• Stock promotion of a poorly organized online gaming roll-up • CEO FitzGerald has a checkered past with ties to questionable people • Ties to Amaya, a company being investigated by regulators • Management Incentive Program is flawed and unjustly enriches insiders • Questionable financial reporting and accounting practices • Overvaluation: 45%-70% downside	• Poorly promoted Canadian healthcare company, with limited product value • Disclosure issues obfuscate actual end market sales, and overstatement of total addressable market • Over-promotion of a partnership with Getinge that would be destined to fail • Terrible insider alignment with mgmt. owning 1% of shares • 80%+ downside when Getinge deal fails	• Growth by deceptive sales tactics of a service with limited value • Reckless debt-fueled acquisition spree has stretched the balance sheet • Diverting investors from problems by creating metrics that overstate results • Dividend at high risk of being cut • 46%+ downside risk to $4/share	• MDA's acquisition of DigitalGlobe driven by the need to cover problems in its satellite business, including a forthcoming decline in the geostationary satellite industry • Brazen accounting scheme including inflation of intangible assets to overstated Non-IFRS EPS • Dangerously levered at 5.8x when taking into account off-balance sheet liabilities make Maxar's dividend at high risk of being cut or eliminated • Analyst estimates are too high, and goodwill and asset impairment looms
Successful Outcome	• Intertain initiated a strategic review upon the report release • Feb 2016, CEO FitzGerald resigns from Intertain (source) • Intertain delists from the TSX in Jan 2017 and re-lists its shares in the UK -- claiming that the Canadian markets don't value its business (source) • Analyst price targets of C$28.00 were never achieved. Shares hit a low of C$7.13, down 42%	• On Jan 25, 2018, TSO3 discloses amendments to the Getinge partnership, validating Spruce Point's criticisms (source) • Multiple brokers downgrade shares from >C$5.00 to C$2.00 • Share price made a low of C$0.48 in Oct 2018, down 81%	• Free cash flow available to pay the dividend has contracted materially • CEO Ken Hartwick resigned within 7 months after our report (source) • CFO resigned a little more than a year after our report (source) • Share price made a low of $3.48 in June 2018, down 51%, which exceeded our low share price target	• Maxar's twice attempted to "refute" our conclusions, yet its share price lingers near a multi-year low • Maxar admitted that it is evaluating an impairment of assets and that *"it is possible that an impairment or write-down will be recognized in Q3'18"* • The Company also clarified its capital allocation strategy, and suggested that debt pay was a priority, leaving the safety of the dividend in question (source)

Executive Summary

Spruce Point Believes Dollarama (TSX: DOL) Is A "Strong Sell" With ~40% Downside Risk

Dollarama (DOL or "the Company") is a dollar store which, following a series of price hikes over the course of several years,is no longer a true "dollar store." As a result, DOL has fallen out of favor with value-oriented customers, causing average store traffic to contract and thus necessitating further price hikes to support SSS growth. Management is nonetheless aggressively pursuing unrealistic growth targets even as competitors flood the discount retail market and threaten its improbable margins. DOL's shares trade at a 50% premium to peers in the value retail space – even following a ~20% drop after a disappointing Q2 – questionable governance and poor earnings quality notwithstanding. We believe that DOL will continue to miss lofty investor expectations, and that its premium valuation will continue to be pressured.

A Retailer Of Low-End Products With Declining Fundamentals In An Increasingly Competitive Environment

- Undifferentiated Products: Dollarama sells a variety of low-priced products, mostly sourced directly from China. Its purported advantage in "sourcing" is contradicted by conversations with industry sources as well as numerous IP infringement lawsuits filed against the Company.
- Moving Upmarket Is A Risky Strategy: Faced with years of negative average traffic growth and an increasingly saturated market, Dollarama is driving comparable store sales growth by selling higher-priced items. However, in doing so, it is quickly losing its reputation as a true "dollar store," and per-store traffic numbers are declining as a result. Big Lots (NYSE: BIG) undertook a similar strategy in the 2000s, but reversed course after admitting its failure.
- Saturation Is Imminent: Dollarama cited a 900 store target at the time of its IPO in 2009, when it had just 585 stores. Management has since revised this number upwards multiple times: first to 1,200, then to 1,400, and most recently to 1,700. Our analysis shows that this target is unrealistic, and that the market is already bordering on oversaturation. Dollarama's FY '19 store opening pace has thus far been its slowest in years.
- Margins Inexplicably High And Likely Unsustainable: Gross margins of 39-40% are remarkably high for a discount retailer, but intensifying competition, rising labor costs, rising transportation costs, and a lapsing currency hedge benefit all threaten Dollarama's high profitability levels. Patterns in Dollarama's hedging profits and gross margins ex-hedging suggest that management may be leaning on its FX-related profits to prevent its headline gross margin number from declining (see note on next page).

Troublesome Management And Governance Red Flags

- Founding Family (And A Director) Have Significant Related-Party Deals: The Rossy family launched Dollarama from its legacy retail chain in 1992 and owns significant real estate assets that are employed by the enterprise. This may have played a role in management's recent decision to acquire Dollarama's existing Montreal distribution center from the Rossys rather than open a second distribution facility in western Canada, as have most peers.
- CEO Stepped Down And Installed His Son: Larry Rossy stepped down as CEO in 2016 (and as Chairman in 2018), selecting as his replacement his son Neil – previously Dollarama's Chief Merchandising Officer. We question whether a thorough and arms-length search was conducted to fill this position.
- Opaque Supplier Relationship: As part of a deal struck in 2013, Dollarama supplies goods (at an undisclosed profit margin) to Central American discount retailer Dollar City in exchange for an option to acquire the chain in 2020. However, Dollarama currently has no formal stake in Dollar City, and therefore does not consolidate Dollar City's results. We are concerned that Dollar City could be overpaying its vendors to lessen the financial burden on Dollarama.
- Insider Ownership Declining: Former CEO Larry Rossy has sold or transferred ~75% of his shares since the 2009 IPO. Bain Capital liquidated the last of its shares in 2011 at a split-adjusted price of $5 per share, 1/8th the current price. The current CFO owns no shares and regularly liquidates options.

Spruce Point Believes Dollarama (TSX: DOL) Is A "Strong Sell" With ~40% Downside Risk

Questionable Accounting Techniques And Capital Allocation Decisions Weaken Quality Of Earnings And Financial Position

- Currency Hedge Supposedly A Pure Offset To CAD Depreciation, But Has Been A Material Profit Center: Dollarama claims to hedge currencies only to lock in consistent prices (in CAD) on which its customers can rely. However, in practice, the Company adjusts prices to match non-hedged competitors, leaving us to wonder why it hedges at all. Much of the recent hedge benefit appears to have reversed, but gross margins ex-hedges conveniently rose by *just* enough over the last two years to maintain steady profitability. If nothing else, we question whether Dollarama's elevated margins are sustainable.
- Tenant Allowances And Leasehold Improvements Are Amortized Over Very Different Periods: While accounting rules may give sufficient leeway to permit this difference, we question why lease term assumptions should differ for these two capital accounts. Earnings quality suffers notwithstanding.
- Sales Of Certain Assets, Such As Vehicles, Appear To Be Completed At Above-Market Prices: While the financial impact of these moves is difficult to quantify (perhaps due in part to Dollarama's opaque relationship with Dollar City), the liquidation of certain assets is significant in some quarters.
- Leverage Is Increasing: Dollarama makes long-term financing decisions using short-term debt, the cost of which has risen with recent debt issuances and is likely to continue to increase with rising interest rates – and as the Company's credit profile grows riskier. We question management's decision to increase leverage to support buybacks and dividends simply because the earnings yield is above the after-tax cost of debt. We also worry about the state of the balance sheet should the economic environment turn, or should the business decline more rapidly.
- Depreciation Is Well Below Capex And Has Been For Years: Capital spending easily bests industry peers, both as a percentage of sales and vis-à-vis steadier D&A charges. The mismatch with D&A suggests poor quality of earnings at the very least. Meanwhile, management's growth orientation has diverted capital spending away from store remodeling, giving stores a stale and dated feel despite rising price points.
- Acquiring Real Estate Flatters EBITDA: Acquiring related-party real estate not only lines the pockets of the founding family, but also allows Dollarama to shift rent expenses out of the operating line. The artificial EBITDA boost helps management to achieve its EBITDA-based compensation targets.

Easy To Justify ~40% Downside In DOL Shares

- Valuation Is Indefensible: DOL currently trades at a ~50% premium to peers and carries among the highest multiples of any global retailer. Higher only are the valuations of crème de la crème global fashion brands – Hermes, Prada, Ferragamo, etc. Such lofty multiples are inappropriate for a dollar store with serious near-to-medium-term business risks. Analyst estimates are not sufficiently skeptical of management's targets in light of these concerns.
- Even If Nothing Goes Wrong, The Stock Is Overvalued: Even if Dollarama executes its growth plan perfectly, maintains its world-leading margin, and retains a hefty valuation premium to its peers, the stock is at best fairly valued at ~$43.
- Under More Reasonable Assumptions, DOL Stock Is Overvalued By 40% At Current Levels: Even assuming that Dollarama achieves full market penetration – with no negative impact on per-store revenues from competition or cannibalization – the stock is worth $28 under normalized margins and at a multiple closer to peer norms, down ~40% from current levels.
- Analysts Bullish, But Wavering: Dollarama's disappointing Q2 – including SSS guidance contraction and a YoY decline in operating cash flow – provoked some downgrades, but analysts still see ~26% upside in DOL shares regardless. We believe that analysts are too trusting of DOL's growth targets, but that the Q2 miss put the Company on notice with a number of analysts. Further disappointing quarters could bring more drastic analyst revisions.

Spruce Point Capital Management

Capital Structure And Valuation

At present, Dollarama demonstrates impressive margins and is not egregiously over-levered on a Net Debt-to-EBITDA basis. However, as competition increases, customers push back against recent price hikes, and operating costs creep upwards, we believe that management will have a difficult time maintaining current profitability levels – particularly while pursuing an aggressive growth strategy. Leverage will be less sustainable should the business' performance decline or the economic environment turn, threatening management's ability to support continued buybacks / dividends while growing store count.

In C$, MM, except per share figures or where indicated

Stock Price	$38.45
Shares Outstanding	332
Market Capitalization	**12,752**
Total Debt Outstanding	1,880
Less: Cash and Equivalents	182
Enterprise Value	**14,450**
Operating Leases	1,130
Finance Leases	4
Adj Enterprise Value	**15,584**

Consensus Estimates (CY)	**2018A**	**LTM**	**2019E**	**2020E**
EV / Sales	4.4x	4.3x	4.0x	3.8x
EV / EBITDA	17.4x	16.7x	16.1x	14.9x
Adj EV / EBITDAR	15.3x	14.8x	-	-
Price / EPS	25.4x	24.1x	22.4x	19.9x

Growth and Margins	**2018A**	**LTM**	**2019E**	**2020E**
Sales Growth	10.2%	8.4%	10.2%	6.5%
EBITDA Margin	25.5%	25.6%	24.9%	25.4%
EPS Growth	22.8%	16.0%	13.0%	12.7%

Credit Metrics	**2018A**	**LTM**	**2019E**	**2020E**
Net Debt / EBITDA	2.0x	2.0x	1.9x	1.7x
Adj Net Debt / EBITDAR	2.8x	2.7x	-	-

Though analysts project declining sales growth, they foresee margin expansion at the same time. This pair of estimates makes little sense to us and should make investors skeptical of consensus estimates.

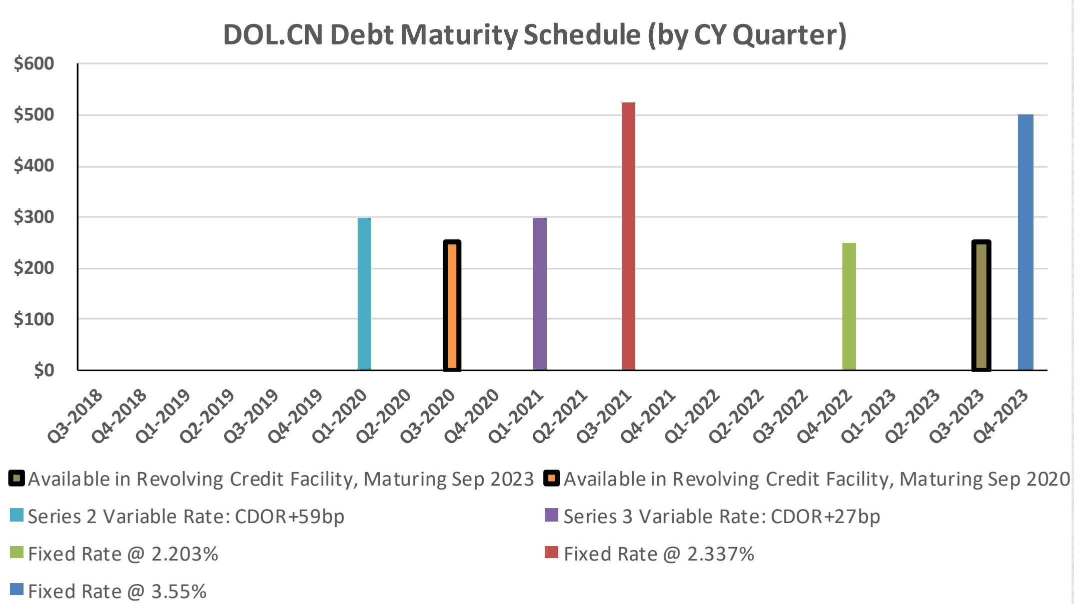
Our research will explain why we believe margins will be pressured going forward.

Source: Dollarama and Bloomberg Estimates
Note: Calendar Year Ended Jan 30th
Note: Operating Leases valued at 6x Operating Lease Expense

Short-Term Debt In A Rising Rate Environment Introduces Refinancing Risk

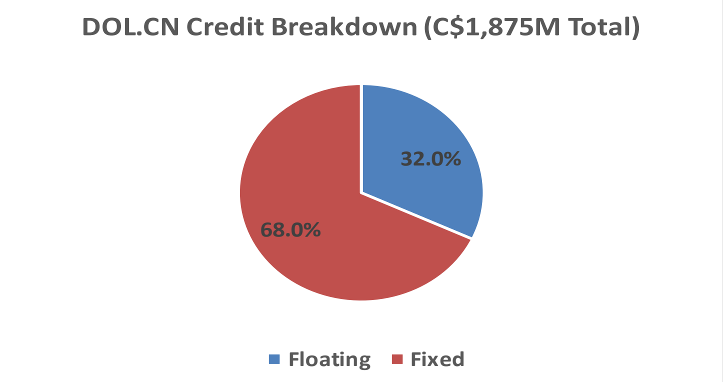
Dollarama refinanced significant short-term debt just last evening, levering up the business in the process. Management refinanced its C$400M of 3.095% fixed-rate notes due this November with C$500M of 3.55% fixed-rate notes due November 2023. Management's use of short-term debt has burdened the business with refinancing risk in an environment in which the CDOR rate has risen sharply and is expected to rise for the foreseeable future, which has now forced the Company to bear materially higher interest expenses (compare to its 2.203% fixed-rate credit due in 2022). The Company still has C$1.4B of debt due to mature within the next 12 quarters (including its credit facility), leaving it exposed to further rate increases. The Company's weighted average debt maturity is about 3.5 years.

Significant Short-Term Debt Maturities That Will Have To Be Refinanced At Higher Rates

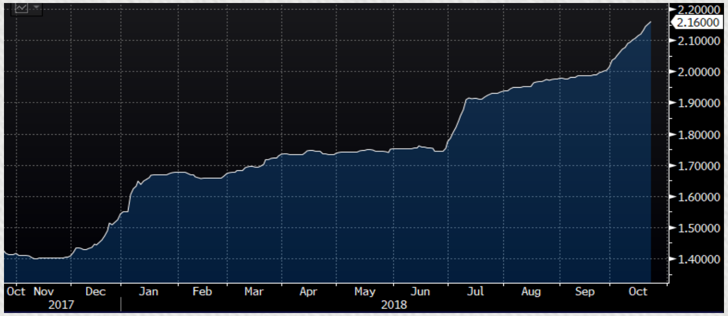


Source: Dollarama

Dollarama Has Unhedged Exposure To Interest Rates…



…While The Three-Month CDOR Rate Rises Rapidly



Source: Bloomberg

Spruce Point Capital Management

Will Dollarama Be The Next Bain Capital-Led Failed Retail IPO?

"Twenty-two percent of Bain LBOs from 1984 to 1992 went bankrupt" **according to Eileen Applebaum in her book "Private Equity at Work."[1] Recent Bain-led retail busts include Toys "R" Us, Guitar Center, and Gymboree.**

Company	Date	Enterprise Value	Bain Capital Quotes	Outcome
Toys "R" Us	March 17, 2005	$6,600	"Toys "R" Us and Babies "R" Us are premiere franchises with strong global brand recognition and a collection of high quality product offerings including toys, children's apparel, and baby products and accessories. We are excited by the prospect of partnering with the management team and employees to strengthen the long-term operating and financial performance of the businesses." -Matt Levin, a MD at Bain	Toys "R" Us Files For Bankruptcy Sept 2018
Michaels Stores	July 1, 2006	$6,000	"We are delighted to partner with the Michaels management team to help build on its already strong position in an attractive industry, and capitalize on the significant growth opportunities that lie ahead. Our deep experience in the retail sector reinforces our conviction that Michaels has the best store locations, a broad and attractive assortment of products for crafters of all ages, and a sustainable competitive advantage thanks to smart investments in systems and infrastructure. We look forward to helping Michaels achieve its full long-term potential." – Matt Levin MD	IPO prices at low end of range (June 2014) Share Price Hits Multi-Year Low in Oct 2018 As SSS Decline
Guitar Center	June 27, 2007	$2,100	"As the leading retailer of musical instruments in the U.S., Guitar Center enjoys great brand recognition among musicians nationwide, a loyal customer base, and a track record of significant growth. We look forward to working with the Company's experienced and capable management team to continue to build the business." Jordan Hitch, a MD at Bain	The End of Guitar Center And Guitar Center Troubles Only Getting Worse
Gymboree	Oct 22, 2010	$1,800	"Gymboree is a terrific company with incredible brand strength and a large population of extremely satisfied customers. We look forward to working with Matthew McCauley and the company's proven and experienced management team" Jordan Hitch MD at Bain Capital. "	Gymboree Hires Restructuring Counsel

1) Source: "Bain Capital Sees High Profile Buyouts Go Bust", NY Post, March 2018

A Low-End Retailer With Unsustainably High Margins

Undifferentiated Goods & Knock-Off Products

Dollarama sells undifferentiated, low-priced consumer goods, competing almost entirely on price. Many of its products are knock-offs. It is no surprise that the Company has been sued by several companies for trademark infringement.

How Dollarama became the retail king of knockoffs

*Selling cheap imitations of more expensive brands has turned Dollarama into one of Canada's most successful retailers, earning it big bucks and **plenty of lawsuits*** (Source)

*"I think they have good lawyers working for them," says David Lipkus, a lawyer specializing in anti-counterfeit in Toronto, who has helped clients sue businesses in Canada selling knock-offs. "Often retailers make mistakes and end up selling fakes." Many lawsuits are settled privately, but **the store has been sued by Nike, for selling counterfeit footwear emblazoned with Nike's iconic basketball player silhouette**, and by Umbra, a home decoration company, for selling a style of waste basket. **In February 2017, Dixon Ticonderoga launched a suit against the dollar store chain for a pencil it's been selling since 2002**.*

Dollarama sells a wide range of discounted knock-offs across product categories. Its business invites litigation.

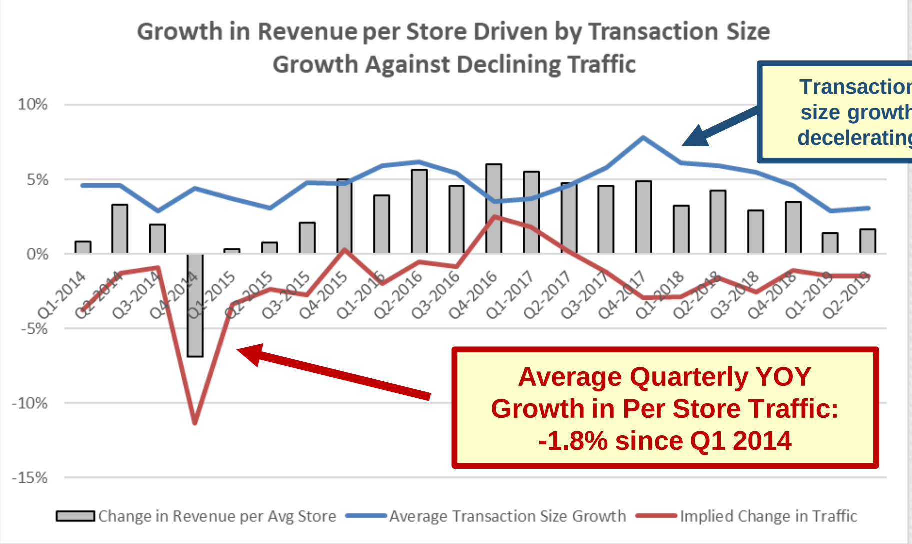
Brazen mimicry: multiple knock-offs of a single producer (Mars)

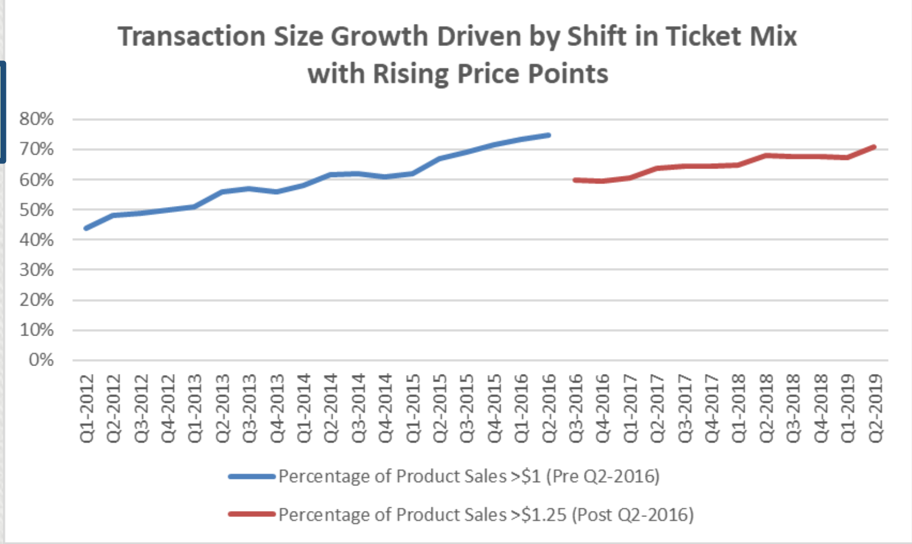
Source

Per-Store Traffic Growth Stagnant, But Opportunities For Price Increases May Be Exhausted

Growth in per-store sales has been driven by transaction size growth against *declining* per-store traffic. Transaction size growth has itself been driven by sales of higher-priced items: Dollarama's maximum price point has risen from $1 prior to FY 2008, to $2 in FY 2008-09, to $3 in FY 2012, to $4 in FY 2017.

Contracting store traffic puts per-store sales growth at risk absent further price increases, but we question whether price-driven SSS growth is sustainable as higher prices erode Dollarama's value proposition and put it in closer competition with more comprehensive big-box retailers. Management has expressed reluctance to raise prices further in the near term regardless (though they said the same when the max price was bumped to $3 several years ago). With recent price increases now lapping for the first time, SSS growth may be at risk.





Growth has been propped up by price increases which have made its products more expensive than those at dollar store peers.

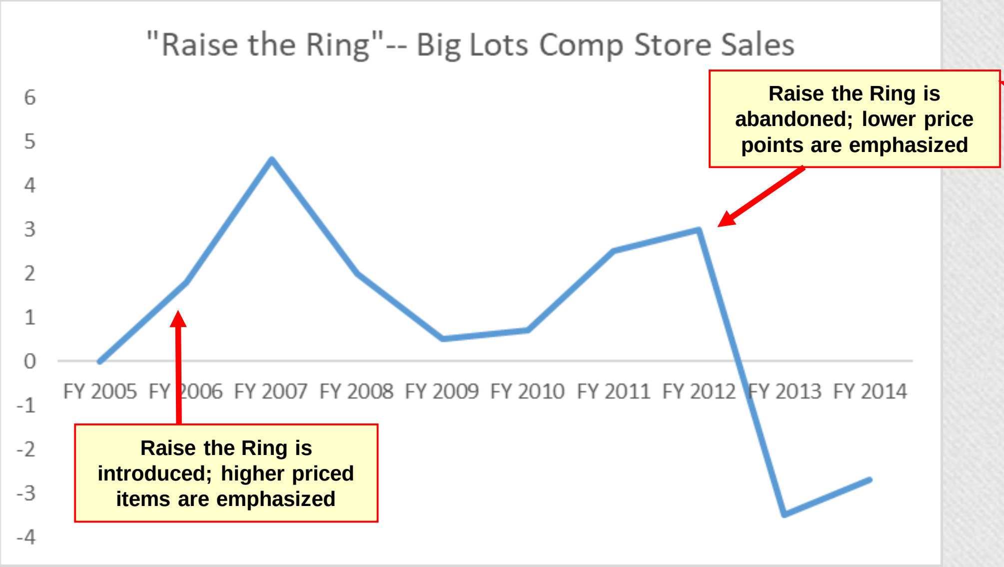
Between a rock and a hard place: Does management continue to erode Dollarama's value proposition with price increases, or keep prices steady and hope for traffic contraction to reverse?

Spruce Point Capital Management

Increasing Average Unit Revenues Is A Very Risky Strategy That Has Failed Before

Raising price points to prop up SSS growth against falling store traffic is a major risk for discount retailers, as their entire value proposition comes from their low prices. Higher prices may turn off customers and create difficult comps in the event that price increases must be paused or reversed due to customer pushback.

In 2006, for example, Big Lots – a U.S. discount retailer – introduced higher-ticket brand-name items in place of comparable budget goods in an effort to get customers to spend more per visit. This strategy reinvigorated same-store sales growth for a time, but ultimately failed. Subsequent difficult comps resulted in negative SSS growth after management abandoned its so-called "Raise the Ring" strategy.



Big Lots alienated shoppers who were seeking cut-price, name-brand goods after venturing into other areas, like selling frozen food:

"Our customer doesn't come to us expecting a Nordstrom's level of in-store shopping experience. They want value, treasures, merchandise on the floor and clean restrooms, and we need to meet those expectations," [CEO Steve] Fishman said in 2005.

…

"We're an enigma," he said at an investor conference this month. "It's been a real challenge for the marketplace." Source

Calls with industry experts indicate that Dollarama is losing more price-conscious customers to Dollar Tree and other discount retailers following its efforts to raise prices, and that this is a major driver behind recent per-store traffic declines.

If price-conscious customers aren't interested in shopping at Dollarama, we wonder who is…

"NothingForADollarama": Customers Becoming Conscious Of Price Increases Versus Competitors

Dollarama's price increases may not yet put its prices on par with those of big box retailers like Walmart, but customers have taken notice that Dollarama has increased prices against other Canadian dollar stores. Comments from various internet forums and news sites reveal that customers no longer believe that Dollarama offers as much value as do other discount retailers, suggesting that the strength of Dollarama's value proposition – the source of its appeal and foundation of its business model – is at risk. The below comments are anecdotal, but comments of this sort regarding Dollarama in particular are nonetheless common among relevant websites.

*"The dollar store is no longer a bargain if you shop around you can by the same things cheaper or same price elsewhere **quit calling it dollarama no more dollar things**."*

Source

"dollar tree here is drastically cheaper then dollaramma" – Cody Williams

*"Cody Williams Same here, **Dollarama is not really a dollar store anymore**." – JJ Walker*

Source

*"I enjoyed the days when everything in Rama actually was a dollar. **I go to Dollar Tree more often now just because everything there is $1.25 - ($1 in the U.S. of course).**"*

Source

***"DollarRama is no longer in the same category** since they sell at higher prices, more of a discounted store and not a dollar store."*

Source

"They gonna have to change the Dollarama name soon"

"dollarandaquarterrama"

"New Name: NothingForaDollar"

*"You forgot 'rama'. **NothingForADollarama**."*

"As for a new name how about FiveFinarama?"

"five or lessarma"

Source

*"Their high prices is the problem, they still have better selection than Dollar Tree but their prices are always higher. **I know some dollar store shoppers who go to Dollar Tree first for the better prices and then go to Dollarama for the stuff they couldn't find at Dollar Tree**. Myself personally have watched the prices creep up. A pair of work gloves climbed from $2.50 to 4 or 5 bucks, **the discount over Home Depot is only a buck or two now**. Also Dollar Tree still keeps all items under 2 bucks I believe."*

Source

Just did a quick check of my cleaning cupboard:

DT=Dollar Tree, DM=Dollarama

- 2.84L bleach, $1.25 at DT. Sometimes they even have the big 3.7L bottles. Never seen bleach that cheap at DM

- 976ml Fabric Refresher $1.25 at DT. DM sells it for $1.50 and it's a smaller bottle.

- Oxy First Force spray cleaner. $1.25 at DT. $1.50 at DM.

DT also has a selection of other spray cleaners at $1.25 while even other no name ones at DM can go up to $2.

- No name dish soap. 1479ml (almost 1.5L) for $1.25 at DT. 500ml for a $1 (or I guess $1.25 soon) at DM.

- No name Mr. Clean sponges. At DT it's two full sponges for $1.25. At DM each sponge is half Mr. Clean cleaner sponge and half normal cheap sponge.

- Those square no name tupperware containers that are 3 for $1.25 at DM are 4 for $1.25 at DT.

At the dollar-ish level everything I've found at DT has been a better value and equal, or better, quality.

Source

SPRUCE POINT CAPITAL MANAGEMENT

Transitioning Away From "Dollar Store" Identity Threatens Customer Loyalty

Perhaps in recognition of the fact that Dollarama is losing its status as a true dollar store, and that it now belongs to a different category, management has stricken almost all references to "dollar stores" from Company filings. This poses a major threat to Dollarama's customer appeal, as evidenced by traffic trends and anecdotal customer reactions.

FY 2017 Annual Information Form	FY 2018 Annual Information Form
The dollar store segment in which Dollarama operates is generally differentiated from that of other value retailers by one or more of the following: (i) low fixed price points; (ii) convenient locations and store size; (iii) broad offerings of everyday branded and unbranded merchandise; (iv) small or individual sized product quantities; and (v) no-frills, self-service environment.	The segment in which Dollarama operates is generally differentiated from that of other retailers by one or more of the following: (i) low fixed price points; (ii) convenient store size and locations; (iii) broad offerings of branded and unbranded merchandise; (iv) small or individual sized product quantities; and (v) no-frills, self-service environment.
Merchandise offered by dollar stores generally includes items in the following categories: household wares, kitchenware, glassware, tableware, linens and towels, storage containers and accessories, home cleaning products, home decor products and seasonal ornaments, books, stationery, greeting cards, giftware, party supplies, toys and games, arts and crafts materials, electronics, souvenirs, novelties, jewelry, clothing, footwear, headwear, costumes, personal care products, cosmetics, over-the-counter pharmaceutical	Merchandise offered generally includes items in the following categories: household wares, kitchenware, glassware, tableware, linens and towels, storage containers and accessories, home cleaning products, home decor products and seasonal ornaments, books, stationery, greeting cards, giftware, party supplies, toys and games, arts and crafts materials, electronics, souvenirs, novelties, jewelry, clothing, footwear, headwear, costumes, personal care products, cosmetics, over-the-counter pharmaceutical products, food,
The Dollarama business was founded in 1992 by Larry Rossy, a third generation retailer. Larry Rossy took the helm of the family retail business in 1973 and transitioned the business from a general merchandise retailer to a single price point dollar store chain. He led the management team to introduce a number of initiatives that have defined the Dollarama business model. These include (i) adopting a fixed price point dollar store concept; (ii) pursuing the store network expansion strategy across Canada, leading to stronger brand awareness and increased sales; and (iii) implementing a program to directly source merchandise from overseas suppliers, thereby reducing merchandise costs and diversifying and enhancing the product offering. The core principles of the model remain unchanged to this day, under the new leadership of Neil Rossy.	The Dollarama business was founded in 1992 by Larry Rossy, a third generation retailer. Over the years, the management team introduced a number of initiatives that have defined the Dollarama business model. These include (i) adopting a fixed price point retail concept; (ii) pursuing the store network expansion strategy across Canada, leading to stronger brand awareness and increased sales; and (iii) implementing a program to directly source merchandise from overseas suppliers, thereby reducing merchandise costs and diversifying and enhancing the product offering. The core principles of the model remain unchanged to this day, and have enabled Dollarama to become a major Canadian value retailer.
• the core offering of consistently available everyday products, which offers compelling value and makes Dollarama stores a destination shopping experience, in contrast to the "treasure hunt" type offering of certain other dollar stores;	• the core offering of consistently available products, which offers compelling value and makes Dollarama stores a destination shopping experience, in contrast to the "treasure hunt" type offering of certain other value retailers;

Margins Are Inexplicably High And Perhaps Unsustainable

We acknowledge that Dollarama is a strong operator with a strong value proposition (though perhaps a declining one). However, we question whether a discount retailer reselling Chinese knock-offs should garner among the highest operating margins of all global retailers, and whether a discount retailer with declining per-store traffic can continue to rely on price hikes for SSS growth.

Dollarama stands out among global consumer companies and retailers – 45th out of 584 global retailers by operating margin (and 12th out of 584 global retailers by revenue multiple)

Selected Screening Criteria	Matches
Security Universe	1019582
51) Trading Status: Active	327373
52) Security Attributes: Show Primary Security of company only	70936
53) Exchanges: Asia Pacific (Developed), North America, Western Europe	41768
54) Sectors (BICS): Retail - Consumer Discretionary, Retail - Consumer Sta...	1229
55) Current Market Cap > 1000 Million	644
56) Latest Quarterly Trailing 12M Operating Margin > 20	19

Equity Screen | Custom Universe | 96)

Refine By <Countries, Sectors, etc.> Group By Securitie

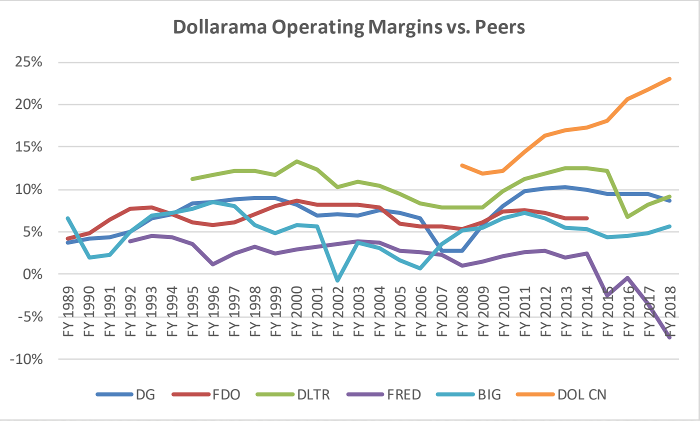
1) Overview | 2) Returns | 3) Valuation | 4) Estimates | 5) Actua

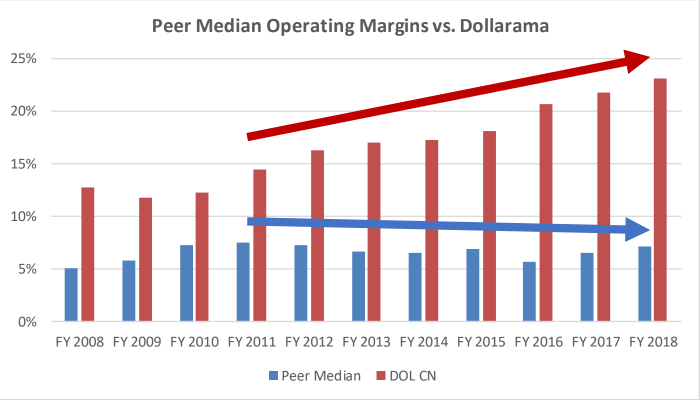
11) Page 1

Name	Market Cap	OPM T12M:Q
		<Enter Filter>
Investable Universe (19)	221.43B	28.76%
31) USS CO LTD	656.57B	48.00%
32) FINCERA INC	1.03B	35.83%
33) TONLIN DEPARTMENT STORE CO	5.99B	33.56%
34) SYSTEM LOCATION CO LTD	5.34B	33.50%
35) START TODAY CO LTD	1.47T	33.20%
36) PANDORA A/S	50.82B	33.03%
37) COPART INC	13.70B	32.29%
38) ICHINEN HOLDINGS CO LTD	33.96B	32.05%
39) ALIBABA GROUP HOLDING-SP...	479.58B	27.70%
40) GWANGJUSHINSEGAE CO LTD	351.20B	26.84%
41) ADVAN CO LTD	52.90B	26.03%
42) KITANOTATSUJIN CORP	95.65B	25.78%
43) JUMBO SA	1.84B	24.66%
44) YA-MAN LTD	102.93B	23.39%
45) DOLLARAMA INC	16.31B	23.14%
46) LAWSON INC	665.99B	22.85%
47) SHIN SHIN CO LTD	1.83B	22.71%

Source: Bloomberg, EQS function

Dollarama consistently produces operating margins materially higher than industry peers, and higher than historical industry norms. This gap has only grown more substantial through the last five years.





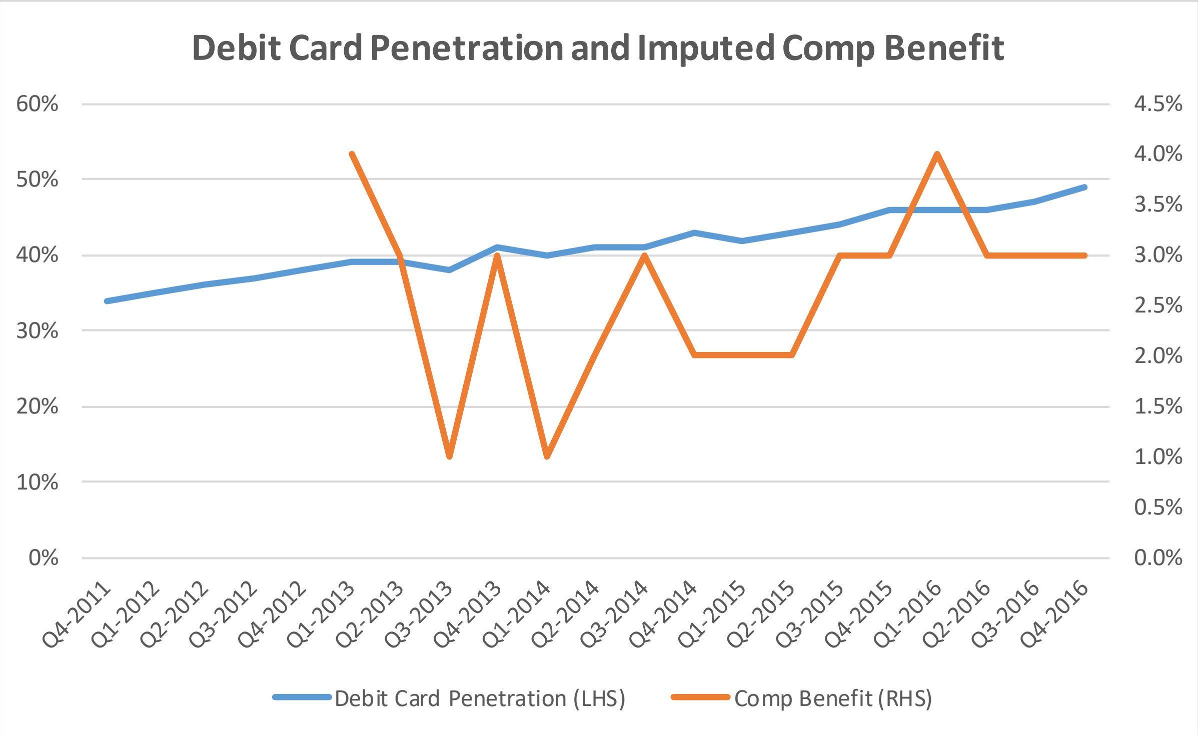
Source: Dollarama and company filings

SPRUCE POINT CAPITAL MANAGEMENT

Debit Card Boost Is Played Out

Dollarama management has characterized the benefit from debit cards as being roughly a doubling in average purchase size. If true, this benefit would be visible in year-over-year sales comps.

The Company has not always disclosed penetration – and they ceased doing so after Q4 2016 – but the data suggest that the average annual comp benefit was approximately 2.5% from FY 2013-16.



Source: Dollarama

Have All The Levers Been Pulled?

Dollarama has done a good job of increasing per-store revenue while investing in initiatives designed to remove operating expenses. We cannot fault management for pulling levers to expand margins, but we believe the low-hanging (and high-hanging) fruit has already been harvested.

Management has also taken creative measures to raise effective average prices without raising prices directly – e.g. by strategically replacing some lower-priced goods with close substitutes at higher price points, and by reducing the size of product bundles (pencils, candies, etc.) without cutting prices. Such back-door avenues to margin expansion may be exhausted by this point: as noted previously, customers are beginning to notice that Dollarama no longer offers a value proposition comparable to competing dollar stores.

	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18
Revenue Levers	Add \$2.50-\$3.00 Price Points			Discounting With Hedged Margins	Add \$3.50-4.00 Price Points	Accept Credit and Debit Cards
Cost Levers	Dollar City Relationship	New POS Terminals	Kronos Labor Scheduling	Wi-Fi & Scanners	New Warehouse Construction	Warehouse Expansion
Accounting and Financial Levers			Depreciation Schedule Change	Direct Profit from Currency Hedges	Leveraged Share Repurchase	

Is this a sustainable practice as value-oriented customers lose faith in Dollarama?

FY 2016 Q4 Earnings Call Q&A

"Thanks and good morning. In the write up, ***in the discussion of the foreign exchange headwinds and gross margin you also said you made select changes to your product mix****. I am just wondering if you could elaborate are there certain categories that's your emphasizing in certain categories, you are deemphasizing* ***I am just wondering what that sentence really meant?****"*

- Peter Sklar, BMO Capital Markets

"It's really an item by item discussion. Where the compelling value remains and ***we are able to take for example two pencils out of a pack and still be competitive*** *to help with offsetting some of the headwinds, that's the way we handle it* ***or in other cases if we replace the product with a new offering that's just as compelling but different at a lower cost potentially****. That's another way Buyers can use that tool to help them with the current challenges."*

- Michael Ross, CFO, Dollarama

Costs Rising On Multiple Fronts

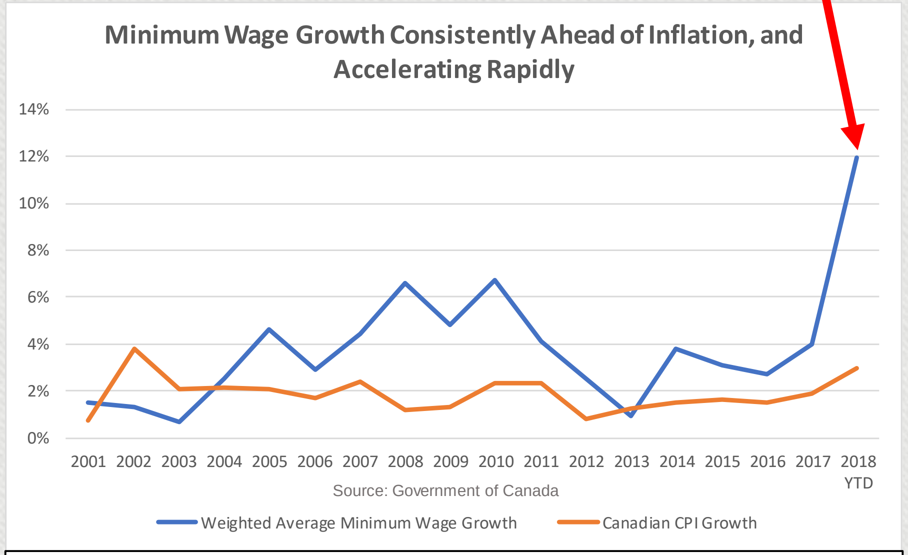
While management may have largely exhausted avenues for price increases and efficiency gains, other industry and Company developments threaten to drive up costs through the near term.

Cost Driver	Explanation
Tariffs	A significant share of goods (~20% according to industry experts) are sourced either directly or indirectly from the U.S. Tariffs could increase costs on these goods materially.
Minimum Wage Hikes	Provincial minimum wages in Canada generally rise much more frequently than do U.S. minimum wages, and many are scheduled to rise on an annual basis based on CPI growth. Minimum wage hikes have been particularly significant of late (see below). Even provinces whose minimum wages are not tied to CPI growth have seen, or are set to see, material minimum wage hikes in the near future. Notable recent and near-term changes are as follows: • **Alberta**: From \$13.60 to \$15.00 on October 1, 2018 (**10.3% increase**) • **British Columbia**: From \$12.65 to \$13.85 on June 1, 2019, to \$14.60 on June 1, 2020, and to \$15.20 on June 1, 2021 (**6.3% CAGR**) • **Ontario**: From \$11.60 to \$14.00 on January 1, 2018 (**20.7% increase**), and to **\$15.00 on January 1, 2019 (additional 7.1% year-over-year increase)**. Will rise according to Ontario CPI growth every October 1 each subsequent year. New Ontario Premier Doug Ford is looking to reverse these plans. • **Quebec**: Just increased to \$12.00 (+6.6% in May 2018). Significant political push to set provincial minimum wage at 50% of average provincial minimum wage by 2020 • **Manitoba, New Brunswick, Newfoundland, Nova Scotia, Ontario, Saskatchewan, and Yukon**: Annual minimum wage hikes according to national or local CPI growth Employee remuneration for FY 2018 was just over 10% of Dollarama revenue. **This cost item could realistically grow at a high single-digit rate over the next 2-3 years, even if headcount is reduced**.
Transportation and Logistics	Industry experts have expressed concerns regarding near-term transportation cost increases. These would hit Dollarama particularly hard, as Dollarama is unique among industry peers. It has only one distribution center. Rather than invest in a second, Dollarama recently purchased its existing distribution center in Montreal – which it previously leased from the Rossy family – for \$39.4M (in addition to \$23.2M spent on adjacent land). Other large Canadian value retailers generally have two distribution centers – one in the eastern half of the country and one in the western half. Rising fuel costs could result in materially higher transportation expenses, as **Dollarama distributes 92% of its merchandise through its single distribution center**. Industry experts suggest that **shipping goods to Vancouver from Montreal via truck can be almost twice as expensive as shipping to Vancouver from China**. We find it interesting that Dollarama chose to purchase property from management's family rather than follow industry norms and open a second distribution center in western Canada, and that five of its six warehouses – all located in greater Montreal – are also leased from the Rossy family (the sixth warehouse is company-owned, built on land purchased from the Rossy family).
Marketing	Dollarama has historically operated with no marketing expense. However, U.S. peers spend 1-2% of revenue on average on marketing (see subsequent slides). As competition increases across the Canadian discount retail industry, management may be forced to expand marketing efforts.

Minimum Wage Growth Historically High And Accelerating Rapidly

Canada has seen fairly consistent minimum wage hikes since 2000, and minimum wage growth has outpaced inflation in all but three years since the beginning of the millennium. Dollarama has been able to manage minimum wage hikes and maintain impressive margins since going public in 2009. Note, however, that minimum wage growth from 2009-17 was comparatively mild relative to the prior half-decade. Accelerating minimum wage growth through the near term will test management's ability to insulate margins from rising labor costs.

12% weighted average minimum wage growth across Canada, driven by 20.7% hikes in Ontario. Average minimum wages could very realistically continue to grow at high single-digit rates through the next ~2 years if planned hikes are enacted.

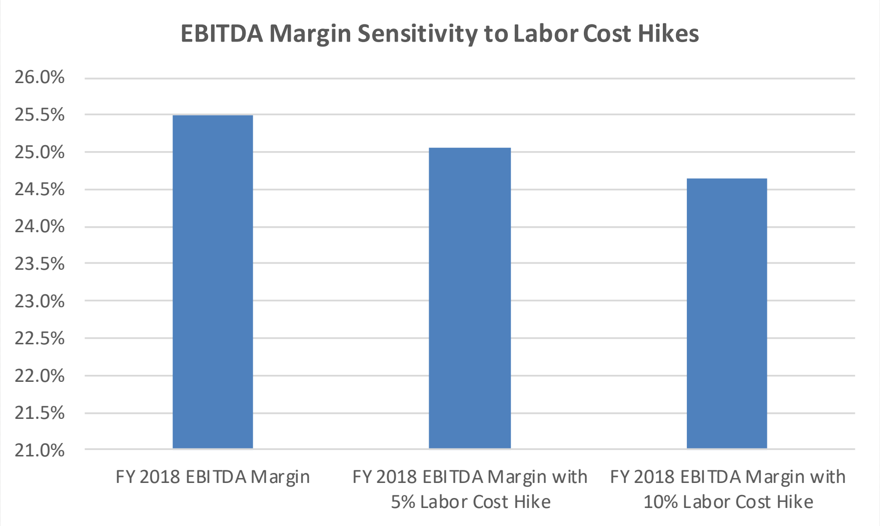


Minimum wage growth across all Canadian provinces, weighted by province population

With labor costs representing about 10% of Dollarama revenue, profitability is materially sensitive to changes in this item.

If labor costs were 10% higher in FY 2018, EBITDA margins would have been slashed by 80 bps.

Labor cost expansion of this magnitude would be significant, but is not necessarily out of the question within 2-3 years.



Management states that the vast majority of employees make more than minimum wage. Nonetheless, minimum wage hikes of 10-20% in Canada's most populous provinces could put material upward pressure on labor costs – particularly if these hikes spread to Quebec, where Dollarama's distribution center and all of its warehouses are located. Management includes a risk factor to this effect in its MD&A.

Lack Of Transparency Regarding Dollar City Is A Serious Concern

In 2013, Dollarama entered into an agreement to export and sell products to Dollar City, a Latin American dollar store with a presence in El Salvador, Guatemala, and Colombia. In exchange for selling goods to Dollar City "at cost" plus a small markup, and providing business and operational expertise, Dollarama was given an option to acquire the chain, exercisable in February 2019 (since extended to February 2020).

Details about Dollar City are scarce: Who is the management? Where is company headquarters? Who are the shareholders? Dollar City's website provides limited information, and not a single Dollar City manager was quoted at the initiation of the relationship.[1] Though management claims to sell to Dollar City "at cost" with a markup, we have no way of determining how they are calculating "cost." It is more likely that Dollarama loads shared costs into the Dollar City bill that flatter Dollarama's margins, and sells merchandise that isn't selling well in Dollarama stores to Dollar City.

Source

1) Dollar City website and press release announcing the relationship

Why are Dollarama shopping carts being repurposed for Dollar City use?

Perhaps they were sold above-market to Dollar City in FY 2013, when the relationship began. Could this be the reason for an unexplained $14.9M disposal of leasehold improvements that year?

Q – Keith Howlett: *"On Note 5 [of the FY 2013 Annual Report], I was trying to figure out the **leasehold improvements**, there seemed to be some items called 'disposals at cost,' and there's sort of an offset there."*

A – Larry Rossy, CEO: *"I don't know what they are. You're going to have to help me out, guys, here."*

A – Michael Ross, CFO: *"Disposal of costs, that would be fixtures or related to…"*

A – Rossy: ***"I would say cars."***

A – Ross: ***"Cars. Yeah, okay. We sold a few cars."***

Q – Howlett: *"Oh, I see, okay. Well, it **shows up as CAD 15M for a year, that's a lot of cars.**"*

A – Rossy: ***"Oh, it's a very expensive car."***

Source: FY 2013 Q4 Earnings Call

5 Property and equipment

	Store and warehouse equipment $	Computer equipment $	Vehicles $	Leasehold improvements $	Computer software $	Total $
For the year ended January 29, 2012						
Opening net book value	81,620	1,737	1,662	[illegible]	[illegible]	152,081
Additions	27,429	1,890	1,426	[illegible]	[illegible]	54,753
Disposals, at cost	(49)	-	(1,095)	(15)	-	(1,159)
Accumulated depreciation on writeoff of fully depreciated assets	15	-	852	4	[illegible]	[illegible]
Depreciation charge	(18,699)	(1,143)	(606)	(10,452)	(2,593)	[illegible]
Closing net book value	90,316	2,484	2,239	71,138	6,876	[illegible]
As of January 29, 2012						
Cost	171,640	5,485	3,379	118,236	21,171	319,911
Accumulated depreciation	(81,324)	(3,001)	(1,140)	(47,098)	(14,295)	(146,858)
Net book value	90,316	2,484	2,239	71,138	6,876	173,053
For the year ended February 3, 2013						
Opening net book value	90,316	2,484	2,239	71,138	[illegible]	173,053
Additions	36,426	700	1,081	[illegible]	[illegible]	75,163
Disposals, at cost	(492)	-	(881)	(14,925)	-	(16,298)
Accumulated depreciation on writeoff of fully depreciated assets	346	-	596	14,383	-	15,325
Depreciation charge	(22,579)	(1,249)	(694)	(12,921)	(2,103)	(39,546)
Closing net book value	104,017	1,935	2,341	89,201	10,203	207,697
As of February 3, 2013						
Cost	207,574	6,184	3,580	134,837	26,601	378,776
Accumulated depreciation	(103,557)	(4,249)	(1,239)	(45,636)	(16,398)	(171,079)
Net book value	104,017	1,935	2,341	89,201	10,203	207,697

CEO Larry Rossy and CFO Michael Ross mischaracterized the sale by attributing it to vehicles, which has its own category…

Source: Dollarama 2013 Annual Report

More Competition Coming To An Already-Crowded Space

Evidence Of Dollarama Store Growth Slowing

The pace with which Dollarama opened stores through the past several years does not appear to be sustainable. Importantly, the inevitable reversal in its pacing appears to be occurring this year.

The Company opened just eight stores in Q2'19, its lowest store opening count in any quarter of any recent year. Its YTD FY 2019 pace of 18 new stores is also trailing the average pace of recent fiscal years (28 openings) by ~35%. Management did not provide a fully satisfactory explanation for this deficit.

The slowdown in its pace of store openings could suggest that the Company is having a difficult time identifying economically-viable locations as it seeks to grow its store count by close to 50% – still a very distant target.

Fiscal Year	Stated New Store Opening Goal	Q1	Q2	First Half	Q3	Q4	Total
2019	**60-70**	**10**	**8**	**18**	**??**	**??**	**??**
2018	60-70	13	17	30	10	25	65
2017	60-70	8	13	21	18	26	65
2016	None	17	17	34	16	25	75

Source: Dollarama financial filings

*"**I want to ask about the pace of store openings.** As you noted the slower start to the year, you did maintain the guidance for this year. But wondering about sort of further beyond that, obviously, the store potential that you put out there gives you room to remain at that pace for a while. But **does the slower same store sales assumption change your thinking about how aggressively you want to push new stores out there?**"*

- Mark Petrie, CIBC

*"**No, it does not. It does not.** And that I would also add that if the pace at which we've been opening stores this year is slower than last year, as mentioned often, **that just relates to the specific timing of real estate.** And if stores are pushed closer to the end of the year, it could be that there is an overlap between a few more stores at the end of this year or a few more stores in the beginning of next year, and the end, it will keep our pace of 60 to 70."*

- Michael Ross, CFO, Dollarama

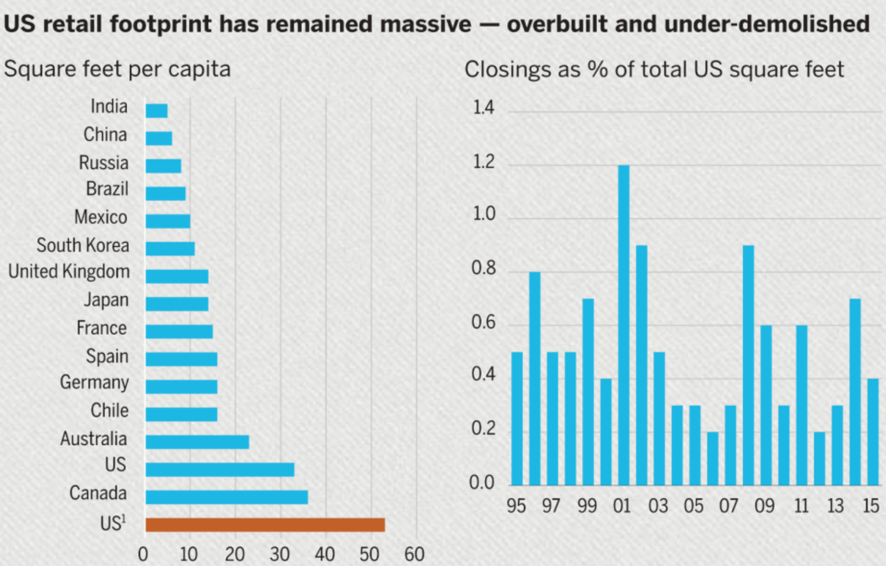
"Real estate timing issues" do a poor job of explaining a drop in H1 new store openings of over a third.

Source: Dollarama Q2 FY 2019 Earnings Call

Dollarama Potentially Pushing The Limits Of The Canadian Market

Management's stated goal is to have 1,700 stores across Canada by 2027, up from 1,178 stores today. We do not believe that it can achieve this without risking significant cannibalization. DOL's target would imply a saturation level higher than the largest U.S. dollar stores (Dollar Tree and Dollar General), which also sell many more consumables and grocery items. Additionally, Canada broadly has much lower levels of retail space per capita than the U.S., suggesting that Canadian concentration is even more pronounced all else equal.

U.S. Retail Square Footage Greater Than Canadian Retail Square Footage



[1]US (orange) adjusted for Costar data to exclude freestanding non-restaurants | Sources: Euromonitor, Costar, ICSC & CSFB

Retailers with similar store concentrations per capita across both the U.S. and Canada are effectively more concentrated in Canada vis-à-vis the total retail space in either country

Source: Wellington Management

Walmart is not opening stores in Canada, suggesting that it believes the Canadian market is saturated at 11.4 stores per million people – about 69% of its U.S. concentration (16.4 stores per million people).

Meanwhile, Dollarama continues to expand within Canada despite even higher Canadian concentration (32.7 per mil) relative to the U.S. concentration of large U.S. dollar stores (45.2 per mil, for a 72% ratio). This ratio would be over 100% at DOL's 1,700 store target.

Store Count by Region

	Canada	US	Can/US Ratio
WMT	410	5,358	7.7%
DOL – Present	1,178	14,750	8.0%
DOL – Future	1,700	14,750	11.5%

Higher Canada store count vis-à-vis comparable U.S. store count compared to Walmart

Store Count per Million People, by Region

	Canada	US	Can/US Ratio
WMT	11.4	16.4	69%
DOL – Present	32.7	45.2	72%
DOL – Future	47.2	45.2	104%

Higher Canada store concentration vis-à-vis comparable U.S. store concentration than Walmart

	DOL CN	DG	DLTR
Stores	1,700	14,760	14,732
Population (M)	36	326	326
Stores/Capita (M)	47.2	45.3	45.2

DOL's Target Implies Greater Than U.S. Saturation Despite Narrower Concept

Dollarama Has Benefited From A Benign Competitive Environment

Large competitors have been shuttering Canadian stores continuously through the last four years due to company-specific issues, highlighted by the high-profile exits of Target and Big Lots from Canada.[1,2] We believe that this has been a significant tailwind for Dollarama, but one that is largely behind the Company at this juncture.

Dollarama has been able to maintain significant share, high margins, and high returns on capital in large part due to missteps among peers and the resulting lax competition. This is likely unsustainable in a more competitive environment, as Dollarama has few material competitive advantages: barriers to entry are low, and its discount retailing strategy is not unique. Competent competition from growing industry players – Dollar Tree Canada, Miniso, and Amazon, among others – could be the straw that breaks the camel's back for Dollarama's profitability or growth (or both).

Fiscal Year	Company Exiting Canada	Stores Closed	Revenue	DOL Revenue Capture (Estimated)	Estimated Revenue Benefit	% Revenue Boost
2018	Sears	200	$2,000	3%	$60	2%
2017	Sears	100	$1,000	3%	$30	1%
2016	Target	133	$2,000	6%	$120	4%
2015	Big Lots	78	$155	10%	$16	1%
		Last Four Year Average:			**$56**	**2%**

Note: All numbers are SPCM estimates

1) "Target Canada to close all stores by April 12"
2) "Big Lots Getting Back Out of Canada"

Light Competition Has Allowed The Company To Spend Nothing On Promotion – Until Now?

Dollarama has no promotional expense. Meanwhile, promotional expenses average 1-2% of revenue among U.S. peers. As established competitors continue to expand, and as new competitors enter the market (Amazon included), Dollarama's no-cost marketing strategy may prove untenable.

Promotional Expense as a % of Revenue

	2016	2017	2018
BIG	1.80%	1.80%	1.70%
FIVE	2.64%	2.70%	2.43%
DLTR	0.21%	0.29%	0.48%
DG	0.62%	0.54%	0.44%
Average	**1.32%**	**1.33%**	**1.26%**

Source: Company financial filings

Intensifying Competition Threatens Dollarama's Passive Marketing Strategy

BUSINESS 05/28/2018 16:56 EDT | **Updated** 05/29/2018 16:01 EDT

Miniso To Expand To 500 Stores As Canada Sees Major Influx Of New Retail Brands

Canadian malls and shopping streets have become a major magnet for international retailers.

- Retailer's aggressive expansion seen as potential threat to Dollarama
- Toronto the top North American city for new retail brands
- 'Asian invasion' promises to change the face of Canadian retail

Source: Huffington Post

Dollar Stores In Expansion Mode As Amazon Launches 'Under $10' Category

The retail trade has become a realm of mass layoffs and hair-trigger stock sell-offs, driven primarily by the rising dominance — part real, part perceived — of **Amazon.com** (AMZN). One retail segment that has so far been left largely unscathed: discount retailers such as dollar stores and off-price chains.

But Amazon quietly recently launched a "$10 & Under With Free Shipping" category. Industry watchers are keenly following the new low-end segment, asking whether the perpetual disrupter can grab market share from an industry group that so far had seemed sheltered.

Source: Investors.com

Dollar Tree: Success fuels growth in Canada

Posted On 12 Dec 2017 By : Retail Environments Staff Comment: 0 Tag: Canada, discount stores, expansions/capacity additions, North America

The Canadian operation is also a relatively small part of the business. However, early results are encouraging, and despite competition in the Canadian market, Dollar Tree has found success. Longer term the company is aiming for 1,000 stores north of the border, which does not seem unrealistic.

Source: Retail Environments

Calls with people at Dollar Tree suggest that the Company is working to imitate elements of Dollarama's strategy and store layout in its own Canadian stores (e.g. raised shelves, etc.), and that it plans to expand into Canada aggressively once its strategy is refined – likely in 2019

Spruce Point Capital Management

Caught Between The Competition: How Will Dollarama Fit In?

__Dollar Tree__ has maintained its reputation as a true dollar store: nothing is priced higher than C$1.25 ($1 in the US)

__Miniso__ has developed a reputation as a "nicer" discount retailer: items can cost up to C$25, but the environment is cleaner and more modern, and products are of better quality (but you can still get a dollar-level deal – most products are priced under C$10)

__Dollarama__ has all the character of an old, tired dollar store, but without the dollar prices.
__Who will shop there unless management invests in store updates rather than opening new stores?__
__Value-driven customers are by definition not loyal customers!__

__Miniso__

Clean and modern, but cheap

__Dollar Tree__

No need for price tags, everything's $1!

__Dollarama__

Looks like Dollar Tree, priced like Miniso

I'll pass!

Dollarama Makes No Effort To Appeal Millennials – The Next (And Current) Shopping Generation

Dollarama has zero social media presence, unlike all of its peers. Not only is the Company out of touch with customers in an industry which demands a high level of customer engagement, but its brand is becoming demonstrably stale.

	Facebook	Twitter	Instagram	YouTube	LinkedIn	Pinterest	Google+
Dollar Tree	Yes	Yes	Yes	Yes	Yes	Yes	No
Dollar General	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Family Dollar	Yes	Yes	Yes	Yes	Yes	Yes	No
Big Lots	Yes	Yes	Yes	Yes	Yes	No	Yes
Miniso (Canada / N. America)	Yes	Yes	Yes	Yes	Yes	No	No
Great Canadian Dollar Store	Yes	Yes	No	No	No	No	No
Dollarama	**No**	**No**	**No**	**No**	**No**	**No**	**No**

Until now, Dollarama has largely been a regional brand with satisfactory name recognition in its provincial home of Quebec. Now that the Company is making a bigger push into Anglophone Canada, management should be more proactive in adapting its strategy to new markets and to a new customer base. Yet management continues to employ a strategy more befitting a sleepy regional business: it does not market or work to improve its brand, it does not stay current with trends, it keeps management within the family, and it is not expanding its logistics chain to support coast-to-coast growth (see subsequent slides).

Management wants Dollarama to be a national brand, but it does not appear prepared to run a national business.

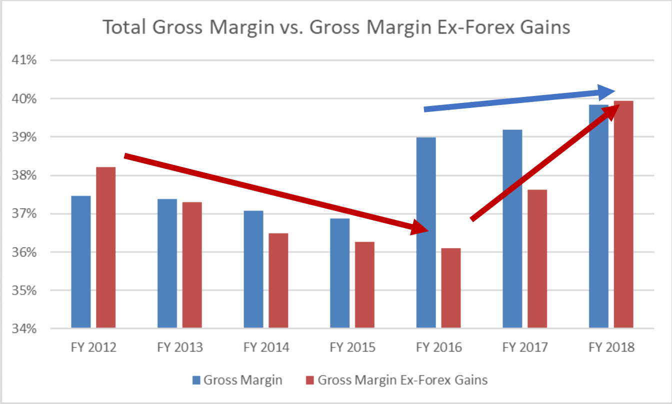
Questionable Accounting And Financial Practices

SPRUCE POINT CAPITAL MANAGEMENT

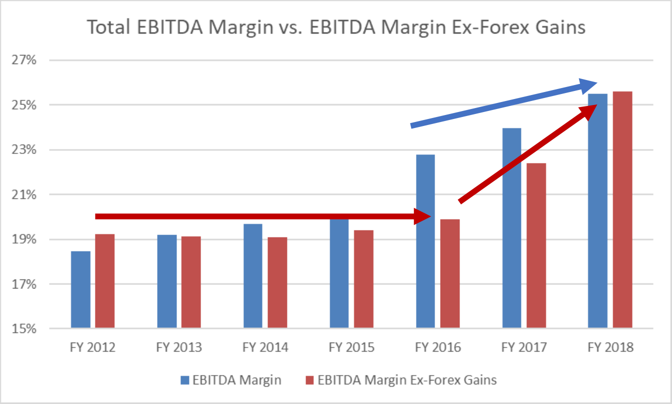
Hedging Instruments A Material Source Of Profits In Recent Years

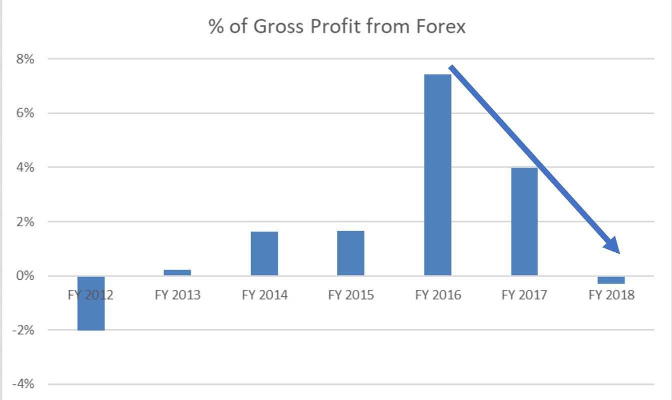
Dollarama's sales are in Canadian dollars, whereas a majority of its product purchases are U.S. dollar-linked. Management claims to enter into CAD/USD hedging arrangements to lock in near-term margins without having to adjust prices in response to FX movements. However, management has nonetheless admittedly adjusted prices alongside unhedged peers in response to shifts in the CAD/USD exchange rate, rendering its currency hedges a source of profit.

Forex dynamics through the last two years have erased the large hedge benefit realized by Dollarama in FY 2016, but management reports that gross margins have effectively remained flat through this period, implying significant gross margin improvement in the underlying business (see graphs below). *As the currency hedge benefit has reversed through the last two years, underlying gross margins have purportedly risen by *EXACTLY ENOUGH* to keep total gross margins steady between 39-40%. We find this oddly convenient – or, at the very least, we question whether management will be able to maintain steady margins in the face of unfavorable FX rate dynamics in the future.*

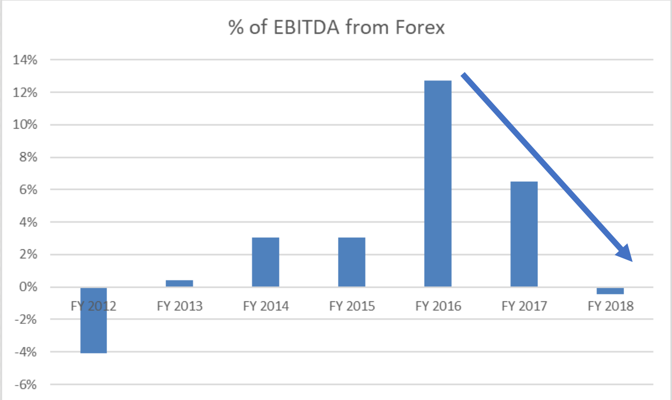


Quick turnaround in underlying profitability! Just in time to keep the declining forex hedge benefit from dragging down margins…





Even as FX hedge gains fell from close to 8% of gross profit in FY 2016 to a drag on gross profit in FY 2018, gross margin expanded by over 100 bps over the same period, implying <u>gross margin expansion ex-forex of almost 300 bps within two years</u> for a retailer with gross margins which were already unusually high, and whose margins had contracted for four straight years before the rapid reversal.



Questionable Depreciation Assumptions

Dollarama changed its depreciation schedule for leasehold improvements (store fixtures) in FY 2015, moving from a 10-year to a 15-year expected life.[1] However, management did not concurrently lengthen the amortization schedule for tenant inducements.

We find this mismatch curious, as both quantities should be amortized / depreciated over the expected life of a given lease.

Adding to the confusion and appearance of foul play, DOL discloses in its AIF that its average lease term is just 5 yrs, and it just started disclosing related-party dealing with Director Huw Thomas of SmartCentres – a REIT that lists DOL as a top 10 customer.[2,3]

C$, Millions	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Amortization of Tenant Allowance	$2.9	$3.5	$4.3	$4.9	$4.8	$5.1
Starting Balance Sheet Amount	16.8	20.7	23.2	28.0	34.4	38.6
Amortization as a % of Asset Amount	17.3%	16.9%	18.5%	17.5%	14.0%	13.2%
Implied Lease Term	**5.8**	**5.9**	**5.4**	**5.7**	**7.2**	**7.6**
Leasehold Depreciation Expense	$12.9	$16.6	$10.8	$14.1	$17.2	$20.2
Starting Balance Sheet Amount	118.2	134.8	176.2	211.3	249.9	286.7
Depreciation as a % of Asset Amount	10.9%	12.3%	6.1%	6.7%	6.9%	7.0%
Implied Lease Term	**9.2**	**8.1**	**16.3**	**15.0**	**14.5**	**14.2**
Tenant Allowance Amortization Using Leasehold Depreciation Schedule	1.83	2.55	1.42	1.89	2.37	2.72
Reduction In EBIT If Both Were Put On Same Schedule	**(1.1)**	**(1.0)**	**(2.9)**	**(3.0)**	**(2.4)**	**(2.4)**

Lease term implied by leasehold depreciation expense 2-3x greater than that implied by amortization of tenant allowance

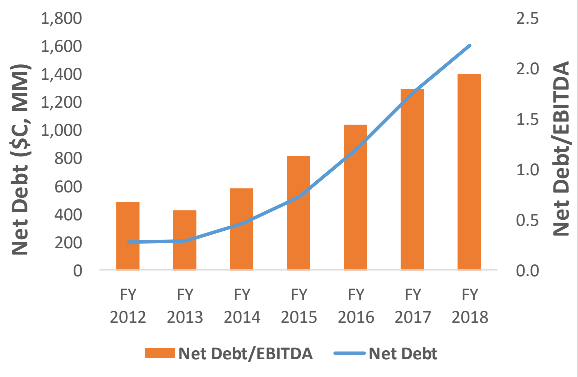
Mismatch in implied lease term inappropriately inflates EBIT

While the financial impact of this adjustment is limited, signs of accounting impropriety do not reflect well on management and cast doubt on the rest of Dollarama's reports and accounting practices

1) FY 2015 Annual Report, p. 15. DOL also extended its store and warehouse equipment useful lives from 8-10yrs to 10-15yrs. The total reduction of these three items was decrease of $10m in FY15 depreciation expense
2) DOL states in its AIF p. 11: *"The Corporation typically enters into leases with base terms of ten years and options to renew for one or more periods of five years each. The average time to expiration of the Corporation's leases is approximately five years."*
3) See governance slide on Huw Thomas

Capital Spending And Distribution Of Cash To Shareholders Are Overextending The Business

Management claimed in 2011 that the business was sufficiently cash-generative to support growth and dividends/share buybacks, and that it would be able to pay down debt while pursuing both. However, debt has ballooned since then, with net debt rising 8x (and close to 3x versus EBITDA growth). Management is effectively levering up the balance sheet to support dividends and share buybacks, with CFO Michael Ross stating that he will continue to repurchase shares as long as the earnings yield remains above the after-tax cost of debt.



*"For the past few years our cash flow has enabled us to continue to pursue our growth plans and continue to pay down debt. **Our free cash flow is now sufficient to fund both those priorities while enhancing new to shareholders through a quarterly dividend payment.** We are able to generate the free cash flow to do all of this because we employ a simple growth oriented business model at Dollarama"*

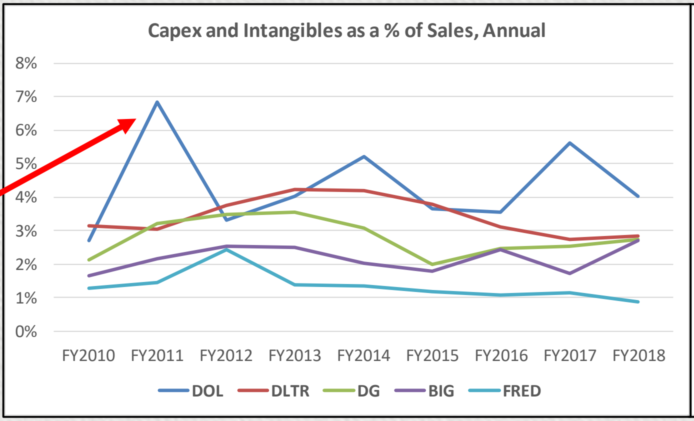
– June 2011 Conference Call

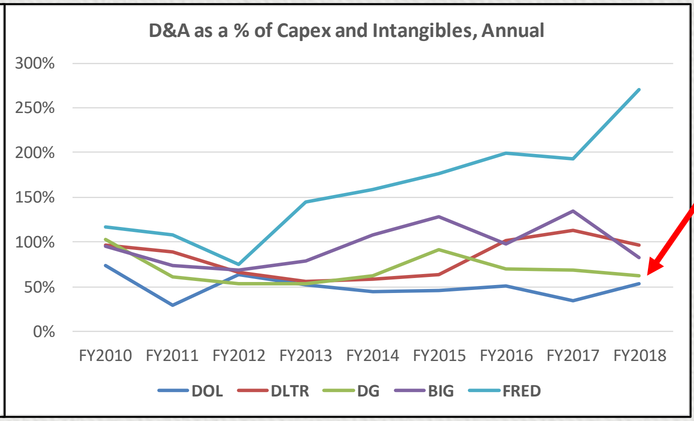
What happened?

Should Dollarama's struggles become more pronounced – or should the economic cycle turn for the worse – this debt overhang could loom large over the business

Dollarama also consistently spends more on capex (as a percentage of sales) than its peers in the discount retail industry, and shows abnormally high capex versus depreciation and amortization. We understand that Dollarama is a growing business, which could explain both patterns in part, but it is not the only discount retailer which is investing in store growth.

Dollarama consistently spends more on capex (as a percentage of sales) than industry peers





Dollarama D&A consistently <50% of capex, and a lower percentage of capex than industry peers

Spruce Point Capital Management

Where Is The Capex Going?

Management has explicitly identified and discussed various capital expenditures in Company filings over the last five years, but this still leaves a large gap versus what was actually spent.

Additionally, there is a large gap between the amount spent on software development and the amortization expense associated with this activity, suggesting that earnings may be inflated.

Undiscussed Capital Spending (FY 2014 – 2018)	
C$, Millions	
$500K in capex spent per new store (375 new stores over past five years: Source: AIF)	$187.5
Capex spent on construction of 500K sqft warehouse in Montreal	67.9
$8.2M spent annually on expansion, renovation or relocation of stores over five years	41.0
$23.2M spent on land acquisition	23.2
Discussed Capex Over Past Five Years	**$319.6**
Total Reported Capex (ex: intangibles)	$520.0
Undiscussed Capex	**$200.4**

Some of this is directed towards leasehold improvements, etc., but with management's focus on expansion over existing store improvements, we question where management is directing this capex

Software Capex and Software Amortization Discrepancy			
C$, Millions	Capital Spending on Software	Software Amortization	Ratio
FY 2018	$19.1	$12.6	1.52
FY 2017	12.6	9.6	1.31
FY 2016	11.1	7.8	1.16
FY 2015	10.8	5.6	1.93
FY 2014	9.8	3.4	2.88

Unlike discount retailer peers, Dollarama did not include software-related spending in capex until recently, and records it separately, in "Additions to intangible assets."[1]

Do they do this to artificially deflate their headline capex figure, thereby inflating reported free cash flow?

Note also that a LinkedIn search for software developers at Dollarama turned up effectively nothing – at best one person with a tangentially relevant title (source). *So where is the software development capex going?*

1) DOL explicitly started calling out software as a component of capex in Q3'16 with the addition of footnote to guidance

Spruce Point Capital Management

Lack Of Transparency Regarding Store Closures And Associated Costs

It is standard industry practice to report store closures, remodels and relocations alongside new store openings. However, Dollarama reports only "Net New Stores" and does not break this number out in detail. Questioned on this in Q4 2016, management answered that a larger store base would inevitably result in more closures for reasons outside of its control (fires, mall renovations, etc.), and that reporting closures would therefore not communicate meaningful information regarding the underlying performance of the business.

<u>We strongly disagree</u>: store closure information is vital to evaluating the health of a retail chain. Management can provide color on particular closures if it feels that they have been done for reasons other than performance, but failing to report closures entirely hides a key operating statistic from investors.

<u>U.S. Dollar Store peers historically close 0.8% of stores annually, yet Dollarama has not reported any recent closures</u>

Company	Store Movement	2012	2013	2014	2015	2016	2017	2018
DLTR	Beginning	4,101	4,351	4,671	4,992	5,367	13,851	14,334
	Opened/Acquired	278	345	343	391	8,850	584	603
	Closed	28	25	22	16	366	101	102
	Closed as % of Beginning	**0.7%**	**0.6%**	**0.5%**	**0.3%**	**6.8%**	**0.7%**	**0.7%**
BIG	Beginning	1,398	1,533	1,495	1,493	1,460	1,449	1,432
	Opened	181	87	55	24	9	9	24
	Closed	46	46	58	57	20	26	40
	Closed as % of Beginning	**3.3%**	**3.0%**	**3.9%**	**3.8%**	**1.4%**	**1.8%**	**2.8%**
DG	Beginning	9,372	9,937	10,506	11,132	11,789	12,483	13,320
	Opened	625	625	650	700	730	900	1,315
	Closed	60	56	24	43	36	63	101
	Closed as % of Beginning	**0.6%**	**0.6%**	**0.2%**	**0.4%**	**0.3%**	**0.5%**	**0.8%**
FDO	Beginning	7,023	7,442	7,916	--	--	--	--
	Opened	475	500	526	--	--	--	--
	Closed	56	26	400	--	--	--	--
	Closed as % of Beginning	**0.8%**	**0.3%**	**5.1%**	**--**	**--**	**--**	**--**
Overall Industry Average		**0.9%**	**0.7%**	**2.0%**	**0.7%**	**2.3%**	**0.7%**	**0.8%**

Other high-growth dollar stores like Dollar Tree and Dollar General report store closures – why doesn't Dollarama?

***<u>Store closures, for whatever the reasons, incur real restructuring and other costs</u>*. Peer retailers generally give detail on these expenses, whereas Dollarama does not.**

We believe that Dollarama should follow industry norms and increase transparency regarding store closures.

SSS Metrics Obfuscate Store Performance

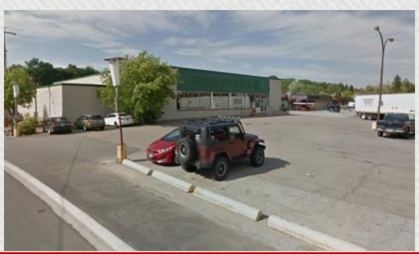
Dollarama's official "Comparable Store Sales" figure includes "relocated and expanded" stores as "comparable stores," therefore picking up growth in traffic which can be attributed to relocation-related improvements. We believe that this likely overstates Comparable Store Sales growth, while also ignoring associated relocation-related expenses.

Huntsville, ON Relocation:
Are these really entirely "comparable" locations?

7 John St., Oct 2012

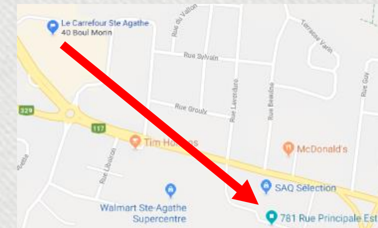
Huntsville Place Mall, Oct 2012

7 John St., Jul 2015



Huntsville Place Mall, Jul 2015

Ste-Agathe-Des-Monts, QC Relocation:
Why assume the costs to make this <1 mile move?



Le Carrefour Ste Agathe, May 2016

Notice Dollarama sign turned inside-out, indicating closure

781 Rue Principale Est, Jun 2009

781 Rue Principale Est, May 2016

Management not only hides store closure data as a supposedly uninformative statistic, but proclaims that it has NEVER closed a store due to poor performance.[1] We find it difficult to believe that a retailer which has existed in its current format since 1992 has never needed to close a store for poor performance. If it has indeed never closed an underperforming store, we wonder whether management has been too ambitious in growing its store base without critically evaluating the profitability of each location.

1) See Q1 FY 2014 earnings call transcript

Spruce Point Capital Management

Cash Flow Beginning To Turn Over Despite Efforts To Bolster Results

In H1 FY 2019, Dollarama's cash flow contracted on a year-over-year basis for the first time since it went public – this despite management's efforts to bolster earnings and EBITDA. The contraction appears to be due in large part to changes in working capital. In particular, we are concerned that growth in inventories suggests that management overestimated near-to-medium term sales growth, and that declining traffic is starting to weigh on the Company.

Dollarama H1 Operating Cash Flow						
C$, Millions	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
Net Income	$105.4	$122.1	$160.3	$189.5	$226.5	$243.3
CFO Before Working Capital	139.4	148.8	212.4	215.6	276.9	299.9
Changes in Working Capital	(28.7)	(23.6)	(87.0)	(11.0)	(12.6)	(88.6)
Net CFO	110.7	125.2	125.3	204.5	264.4	211.3
YoY Change	**$32.6**	**$32.2**	**$0.1**	**$79.2**	**$59.9**	**(53.1)**

Source: Dollarama

Governance Concerns

Spruce Point
Capital Management

Related-Party Transactions With Rossy Family Raise Questions Over Governance And Costs

As noted, Dollarama leases all but one of its five warehouses from the Rossy family, and recently purchased land from the Rossys for the construction of a sixth. Management also recently purchased its Montreal distribution center from the Rossy family, which leased the facility to Dollarama until this February. We understand that the Rossy family has close historical ties to the business, but this level of close dealing draws our attention, particularly given the fact that management has focused on fortifying its existing distribution footprint – closely tied to the Rossy family – rather than invest in distribution facilities in western Canada, where major competitors already have distribution centers.

Dollar Tree Canada Distribution Centers

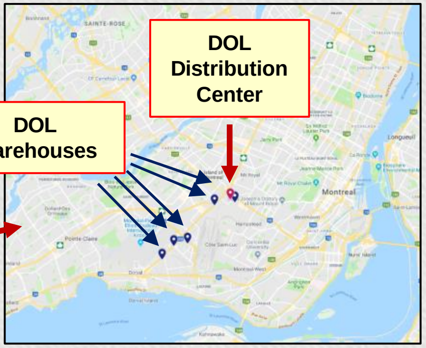
Source: DollarTree

Related-Party Transactions Significant And Growing

Fiscal Year	Rent & Land Purchases Paid to Rossys (C$, MM)	As a % of Compensation Paid to Rossy Family
FY 2019 (To Date)	$39.4	N/A
FY 2018	18.4	166.0%
FY 2017	40.2	445.9%
FY 2016	17.9	130.5%
FY 2015	16.9	275.2%
FY 2014	16.3	190.3%

Source: Dollarama Financials

Dollarama Distribution Centers And Warehouses



No Dollarama distribution facilities located outside of a ~4 mile radius in Montreal

- **Due to preferential relationship with Rossy family?**
- **Will Dollarama be able to expand into Anglo/Western Canada efficiently without logistics costs ballooning?**
- **Overly-exposed to fuel price hikes and rising transportation costs?**

Related-Party Transactions With "Independent" Director Huw Thomas Only Recently Disclosed…..

Dollarama also leases stores from SmartCentres REIT, whose recently-departed CEO, Huw Thomas, joined Dollarama's Board of Directors in 2011, and was a member of its audit committee through March 2017.
His "independence" was recently defended by a meandering 260-word footnote in Dollarama's proxy which belies the fact that Dollarama is a top 10 customer of SmartCentres.
This is all the more suspicious in light of Dollarama's questionable lease accounting highlighted earlier.

Dollarama's Lengthy, Meandering Defense Of Thomas Huw As Independent Only Recently Disclosed (2017)

Huw Thomas is considered independent within the meaning of NI 52-110. Considering that Huw Thomas serves as the Chief Executive Officer of SmartCentres REIT, an entity from which the Corporation leases a number of stores, the Board of Directors expressly reviewed his independent status to conclude that the commercial relationship between SmartCentres REIT and the Corporation could not reasonably be expected to interfere with Mr. Thomas's exercise of his independent judgment and his ability to act in the best interests of the Corporation. The determination of the Board of Directors was based, among other factors, on the following facts: (i) Dollarama L.P.'s contribution to the total gross rental revenues of SmartCentres REIT is not material and represented only 1.7% of the total gross rental revenues of SmartCentres REIT as at December 31, 2017, (ii) Huw Thomas has no involvement in the negotiation of leases on behalf of SmartCentres REIT, as landlord, or in their approval by Dollarama L.P., as tenant, especially since individual leases are not subject to approval by the Board of Directors, (iii) leases are negotiated by management of Dollarama and entered into in the normal course of business, with rental expenses and other lease conditions being established at market terms, and (iv) the leases entered into between the Corporation and SmartCentres REIT do not differ in any material respects from the leases entered into by the Corporation with other major landlords in Canada. Huw Thomas will be stepping down as Chief Executive Officer of SmartCentres REIT in June 2018 but will remain a trustee of SmartCentres REIT.

Source: Dollarama 2018 Proxy Circular

Note: Dollarama did not start disclosing Huw's related-party dealing until the 2017 proxy circular in June 2017 right after he left the Audit Committee in March 2017

SmartCentres Promotes Dollarama Relationship From 2011

RETAIL PROPERTIES	LOCATION	OWNERSHIP	NRA[1] (SQ. FT.)	OCCUPANCY	MAJOR TENANTS
Valleyfield SmartCentre	Valleyfield	100%	161,941	98.0%	Walmart, Dollarama, SAQ, Reitmans

Calloway (now SmartCentres) 2012 Annual Report

Dollarama Recently Changed Rent Expense Disclosure

Rent

Rental expenses charged by entities controlled by a director totalled $18,361 for the year ended January 28, 2018 (January 29, 2017- $18,055).

Source: Dollarama Q4'17 Financials Note 15: Related Party Disclosure

Rent

Rental expenses charged by entities controlled by the Rossy family totalled $4,635 and $10,121, respectively, for the 13-week and 26-week periods ended July 29, 2018 (13-week and 26-week periods ended July 30, 2017 - $5,280 and $11,034, respectively). Rental expenses include charges related to the distribution centre until February 21, 2018, the date on which it was acquired by the Corporation.

Source: Dollarama Q2'18 Financials Note 13: Related Party Disclosure

Dollarama Material To SmartCentres – A Top 10 Customer

Top 10 Tenants

The 10 largest tenants (by rental revenue) account for 49.0% of portfolio revenue as follows:

#	Tenant	Number of Stores	Annualized Rental Revenue ($ millions)	Percentage of Total Annualized Rental Revenue	Leased Area (sq. ft.)	Leased Area as a Percentage of Total Gross Leasable Area
1	Walmart[1]	101	201.8	26.1%	14,107,316	41.3%
2	Canadian Tire, Mark's and FGL Sports	70	34.6	4.5%	1,351,961	4.0%
3	Winners, HomeSense, Marshalls	52	30.4	3.9%	1,336,489	3.9%
4	Loblaws and Shoppers Drug Mart	24	20.6	2.7%	899,056	2.6%
5	Lowe's, RONA	9	18.7	2.4%	1,023,223	3.0%
6	Sobeys	18	17.8	2.3%	782,029	2.3%
7	Reitmans	94	16.0	2.1%	519,650	1.5%
8	Best Buy	23	13.9	1.8%	524,027	1.5%
9	Dollarama	52	12.8	1.7%	491,164	1.4%
10	Michaels	25	11.7	1.5%	477,249	1.4%
		468	378.3	49.0%	21,512,164	62.9%

SmartCentres 2017 Annual Report

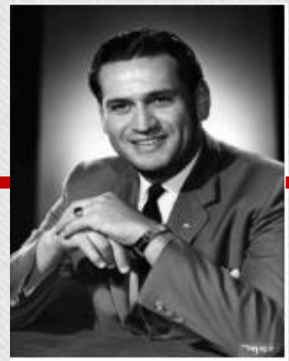
SPRUCE POINT
CAPITAL MANAGEMENT

House of Windsor, House of Rossy: A Case Study In Nepotism

Neil Rossy had been the Senior VP of Merchandising / Chief Merchandising Officer for 25 years prior to being named CEO in 2016. While his family is still a large shareholder, they are not a controlling shareholder, owning around 5% of the shares outstanding. We question whether the Rossy's century-long family tradition of passing down leadership – one which also persists at the Rossy's "sister store" – is appropriate for a public company, or wise for the long-term health of the business.

Salim Rossy

Opened first "S. Rossy" store in 1910 (up-market department store concept)



George Rossy

President of S. Rossy, 1937-1973

Larry Rossy

Grew S. Rossy from 20 to 44 stores before converting all S. Rossy stores to new "Dollarama" concept in 1992. Sold majority stake to Bain Capital in 2004. IPO in 2009.

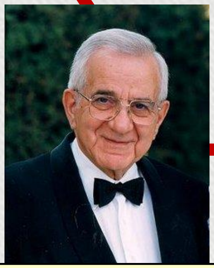
Neil Rossy

CEO of Dollarama as of 2016

Does (or will) the family have a hard time parting with a business that has been in the family for <u>four generations</u>, even if parting ways is the right thing to do?

BONUS:
Brother branches out with separate store…

ROSSY
Your family store



Michael Rossy

Brother of George (one of ten siblings)
Founder & CEO of "Rossy" stores, 1949-2010

Michael DiTullio

Son-in-Law of Michael
President & CEO of Rossy since 2010

Managing retail chains is very much a family affair for the Rossys – at both stores

Perhaps Neil was going to be anointed CEO of Dollarama regardless of the caliber of other potential candidates

Let's hope he's not Commodus!

Insiders Incentivized To Grow EBITDA

Our earlier concerns about EBITDA quality are amplified by the fact that Dollarama executives are compensated based on seemingly arbitrary and inflated EBITDA targets. This gives management a strong incentive to be inefficient users of capital, as any dollar shifted from operating expense to capex has a direct benefit to key executives.

For example, note that management's perhaps questionable decision to purchase one of its Montreal warehouses will shift what was until recently rent expense into depreciation. This change in the accounting treatment of Dollarama's tenancy costs will provide a windfall to EBITDA, potentially boosting management bonuses.

The following table describes the key thresholds of the sliding scale used to establish Bonuses to which the Executive Chairman, CEO, CFO and COO were entitled for the fiscal year ended January 28, 2018, based on the percentage of EBITDA growth compared to the fiscal year ended January 29, 2017. The sliding scale is not capped, and the EBITDA growth percentage thresholds remain unchanged from the previous fiscal year.

Year-Over-Year EBITDA Growth	Payout as % of Target Bonus
< 3.0%	0%
11.0%	100%
19.0%	200%
27.0%	300%

The EBITDA for the fiscal year ended January 28, 2018 grew 17.5% compared to the previous fiscal year. Consequently, the Executive Chairman, CEO, CFO and COO received Bonuses representing 181.0% of their respective Target Bonus. See "Compensation Components Summary Compensation Table" for annual bonuses awarded to each individual. In comparison, for the fiscal year ended January 29, 2017, the EBITDA grew 17.7% compared to the previous fiscal year. Consequently, NEOs received Bonuses representing 184.0% of their respective Target Bonus.

Source: Dollarama Proxy Circular, p. 30

Spruce Point Capital Management

What Is A Stretch EBITDA Goal?

Bonuses are paid upon achievement of 11% EBITDA growth. This level was "*designed to be a stretch objective…. attainable only with significant effort*". However, <u>this target was reset lower after FY 2014 – the only year during which management did not handily exceed the target!</u> We believe this further calls into question the independence of the board and its compensation committee.

Year	EBITDA Growth Objective	EBITDA Growth Achieved
FY 2018	11%	18%
FY 2017	11%	18%
FY 2016	11%	30%
FY 2015	**11%**	**15%**
FY 2014	**13%**	**12%**
FY 2013	13%	22%
FY 2012	13%	26%

Source: Dollarama

"The thresholds were revised by the Human Resources and Compensation Committee in the context of its annual executive compensation review conducted at the beginning of each fiscal year to take into account, among other elements, the fact that the base for the calculation is growing every year."

Source: FY15 Management Proxy Circular

What "other elements" were taken into account?

FY 2015: Growth objective adjusted downwards

FY 2014: Management misses growth objective

Insiders Selling While Company Buys Back Stock At Elevated Prices

Management has been buying back shares at elevated prices through the last several years even while pursuing growth, leavinglittle capital for (sorely needed) store updates or other uses. The average repurchase price since Q1 FY17 is about on par with current share prices and ~40% below our target. Since Q2 FY18, the average buyback price has been 25% above current levels.

Furthermore, just as the Company has been buying back stock at elevated prices, insiders have been offloading shares. Notably, it is evident from past and current proxy statements that CFO Michael Ross has never held onto shares for which he has been granted options: his common equity ownership is listed at zero every year. Note that, as the CFO, it is he who is dictating the share buyback decision in large part.

Using Company Funds To Overpay For DOL Shares…

Period	Shares Repurchased	Value of Repurchase (C$, M)	Average Price (Split-Adj.) (C$)
Q1 FY 2017	1,542,066	139.3	30.11
Q2 FY 2017	2,027,080	184.2	30.29
Q3 FY 2017	1,571,500	157.8	33.47
Q4 FY 2017	2,279,522	224.1	32.77
Q1 FY 2018	1,687,240	180.6	35.68
Q2 FY 2018	1,303,900	160.2	40.95
Q3 FY 2018	687,700	93.1	45.13
Q4 FY 2018	2,425,700	378.8	52.05
Q1 FY 2019	94,500	14.5	51.15
Q2 FY 2019[1]	1,347,341	70.0	51.95
Total	14,966,549	1,602.6	**37.97**
Discount to Current Share Price			**1%**
Total (Since Q2 FY 2018)	5,859,141	717.0	**48.15**
Discount to Current Share Price			**-20%**

Source: DOL filings and Bloomberg

1) All share information prior to Q2 '19 reflects pre-split data, except Split-Adjusted Average Prices. Q2 '19 repurchases were as stated.

While Insiders Sell Into The Company's Bid…

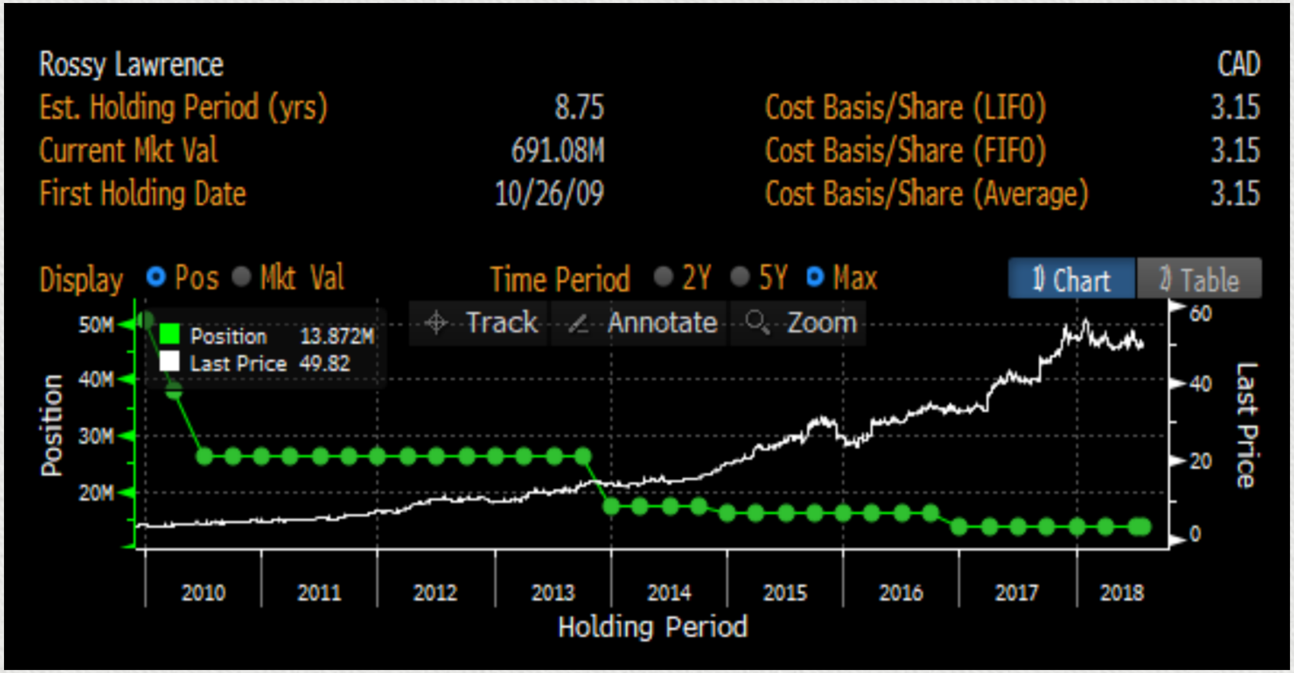
Insider	Title	Date Sold	Shares	Proceeds (C$, M)	Price Sold (Split-Adj.)(C$)
Nicolas Hien	Senior Vice President	4/8/2016	6,203	0.6	32.24
Michael Ross	CFO	4/8/2016	80,000	7.4	30.83
Paul Roche	Vice President	4/18/2016	10,000	0.9	30.00
Geoffrey Robillard	Senior Vice President	6/17/2016	33,500	3.1	30.85
John Assaly	Vice President	9/27/2016	30,000	3.0	33.33
Geoffrey Robillard	Senior Vice President	4/7/2017	20,000	2.3	38.33
Paul Roche	Vice President	4/7/2017	23,100	2.6	37.52
Josee Kouri	Corporate Secretary	4/14/2017	8,000	0.9	37.50
Geoffrey Robillard	Senior Vice President	9/14/2017	5,000	0.7	46.67
Geoffrey Robillard	Senior Vice President	12/11/2017	10,000	1.6	53.33
John Assaly	Vice President	12/13/2017	14,096	2.2	52.02
Geoffrey Robillard	Senior Vice President	1/26/2018	15,000	2.4	53.33
John Thomas	Independent Director	1/26/2018	6,000	1.0	55.56
Geoffrey Robillard	Senior Vice President	6/15/2018	50,000	7.5	50.00
John Assaly	Vice President	6/19/2018	13,404	2.1	52.22
Nicolas Hein	Senior Vice President	6/22/2018	36,750	1.9	51.70
Paul Roche	Vice President	6/22/2018	24,000	1.3	54.17

We do not like the fact that insiders have been selling into share buybacks while the Company levers itself up with short-term debt to support those repurchases. It appears that the execs are levering up the business in part to enrich themselves.

Rossy Family Selling Shares Despite Control Over C-Suite

Notably, Founder and former CEO Larry Rossy has trimmed his position tremendously through the last several years. Though this is to be expected to some extent, as he recently ceded control of the business, we believe that his ownership stake should be held to a higher standard given his insistence on keeping the business in the family.

If he plans to keep the c-suite under a Rossy dynasty, the family's personal stake in the business should reflect that.



Source: Bloomberg

Valuation And Price Target

Spruce Point Capital Management

The Market Has Not Taken Threats To Dollarama Seriously – But Optimism Is Ebbing

Analysts are generally bullish on the stock, focusing primarily on management's growth story and taking current profitability levels for granted. The prospect of new competitive threats to a business which has until now seen limited competition – and the risk that prevailing margins are unsustainable even through the near term – go underappreciated.

Dollarama's poor Q2 cooled analysts' optimism to some extent, but we believe that the reaction was largely reactive and superficial, as they adjusted their price targets in such a way that, in aggregate, they saw exactly the same upside after the post-Q2 dip as they did before. The market still does not fully appreciate the magnitude of the threats facing Dollarama.

All price targets in C$	Before Q2 Release			After Q2 Release			
Firm	Recommendation	Target Price	Upside (on 8/28/18)	Recommendation	Target Price	Upside (on 9/17/2018)	Upside (Present)
RBC Capital Markets	Outperform	$55.00	12%	Outperform	$52.00	22%	35%
Raymond James	Outperform	$55.67	13%	Outperform	$50.00	17%	30%
Macquarie	Outperform	$56.33	14%	Outperform	$49.00	15%	27%
BMO Capital Markets	Outperform	$61.00	24%	***Market Perform***	$47.00	10%	22%
CIBC Capital Markets	Outperform	$59.00	20%	***Neutral***	$46.00	8%	20%
Desjardins Securities	Buy	$58.00	18%	***Hold***	$45.00	6%	17%
Veritas Investment Research Co	Buy	$56.00	14%	Buy	$48.00	13%	25%
Industrial Alliance Securities	Hold	$54.50	11%	***Buy***	$54.50	28%	42%
Canaccord Genuity	Buy	$59.00	20%	Buy	$55.00	29%	43%
Barclays	Equal Weight	$52.00	5%	Equal Weight	$44.00	3%	14%
TD Securities	Buy	$59.00	20%	***Hold***	$49.00	15%	27%
Accountability Research Corp	Buy	$54.00	10%	Buy	$50.00	17%	30%
National Bank Financial	Outperform	$55.67	13%	***Sector Perform***	$48.00	13%	25%
Scotia Capital	Sector Outperform	$55.67	13%	Sector Outperform	$50.50	19%	31%
Wells Fargo Securities	Market Perform	$53.00	7%	Market Perform	$40.00	-6%	4%
AVERAGE:		**$56.26**	**14%**		**$48.53**	**14%**	**26%**

While analysts are still not sufficiently critical of Dollarama, the more recent downward move in the stock and subsequent analyst downgrades may suggest that the market could be primed to evaluate the Company and its growth story with a more discerning eye. We believe that the issues which we highlight in this report will provoke further professional skepticism among analysts and investors.

Spruce Point Capital Management

Dollarama Not Priced *To* Perfection – Priced *Beyond* Perfection

We can get close to DOL's current valuation only if we value it as a mature, ex-growth business *today* under management's lofty goals for the business *for ten years into the future*, applying no discounts for time, business risk, etc.

Mature Business Valuation C$, MM, unless noted	
Stores	1,700
Revenue per Store	$3.2
Total Revenue	**$5,440**
Operating Margin	22.0%
Operating Profit	**$1,197**
Interest Expense	$50
Tax (@27.5%)	$315
Net Income	**$831**
Diluted Shares Outstanding	332
EPS	**$2.51**
P/E Multiple	15.2x
Target Price	**$38.15**
Upside	**-1%**

Management's *ten-year* store target

- **Current store count: 1,178 (70% of long-term target)**

Mature revenue per store estimate

- **Current average revenue per store: ~$2.8M (87.5% of long-term target)**

Average operating margin since Q1 FY 2016

- **Assumes that DOL's unusually high margins are sustainable despite intensifying competition, loss of recent FX benefit, and customer pushback against price hikes**

Industry median NTM P/E multiple

- **Assigns no discount to DOL due to declining store traffic vs. peers, incoming competitive threats, inefficient distribution network, etc.**

Even if Dollarama were a mature business *today* under management's *long-term* targets for the business, DOL stock would not have no upside to current share prices.

The market is pricing DOL beyond perfection – a valuation this lofty cannot be justified today.

Dollarama Not Priced *To* Perfection – Priced *Beyond* Perfection (Continued)

Put another way: The market is implicitly taking it for granted that Dollarama will achieve its lofty ten-year growth targets, assuming sustained profitability levels and per-store efficiency – *and applying close to the industry median FY1 EV/EBITDA multiple to Dollarama's FY 2027 EBITDA!*

FY 2027 Estimates if Management Executes Growth Plans Perfectly (C$, MM, unless noted)	
Stores (Year-End)	1,688
Revenue per Store	$3.3
Total Revenue	**$5,503**
Gross Margin	38.0%
Gross Profit	**$2,093**
SG&A per Store	0.4
SG&A, Total	689
EBITDA (FY 2027)	**$1,404**
Market Cap	12,752
Debt	1,880
Cash	182
Enterprise Value	**$14,450**
EV/EBITDA (FY 2027)	**10.3x**
Industry Median EV/EBITDA (FY1)	**11.0x**

Just under ten-year target

Mature revenue per store estimate (1.5% growth CAGR)

Average gross margin ex-hedge gains since FY 2016

FY 2018 SG&A per Store

Implied FY 2027 multiple close to industry median FY1 multiple

What kind of growth is the market implicitly betting on if we value Dollarama on par with peers?

- **150 more stores than management's ten-year target – *within nine years***
- **4.8% CAGR in revenue per store**
- **Zero margin compression**

FY 2027 Estimates To Justify Prevailing Valuation (C$, MM, unless noted)	
Stores (Year-End)	1,858
Revenue per Store	$4.4
Total Revenue	**$7,929**
Gross Margin	38.0%
Gross Profit	**$3,016**
SG&A per Store	0.4
SG&A, Total	755
EBITDA (FY 2027)	**$2,261**
EV/EBITDA (FY 2027)	**6.2x**
Enterprise Value	13,947
Debt	1,880
Cash	182
Equity Valuation	**$12,249**
Diluted Shares Outstanding	332
Target Price	**$36.93**
Current Price	**$38.45**

158 over ten-year target, *in nine years*

4.8% growth CAGR in Sales/Store

Average gross margin ex-hedge gains since FY 2016

FY 2018 SG&A per Store

Industry median FY1 multiple, discounted @ 7.5% annually

High forecast gives us 4% DOWNSIDE

Valuation Far Out Of Line With Peers And Historical Multiples

DOL shares trade at a 50-60% premium to peers in the discount retail industry. The market is valuing DOL much more like a high-growth tech company than a brick-and-mortar dollar store (and one with concerning fundamental trends at that). Note that this still holds true even after DOL shares traded down significantly following its recent Q2 earnings report.
It is difficult to justify a valuation this high even if one is bullish on DOL vis-à-vis the rest of the industry.

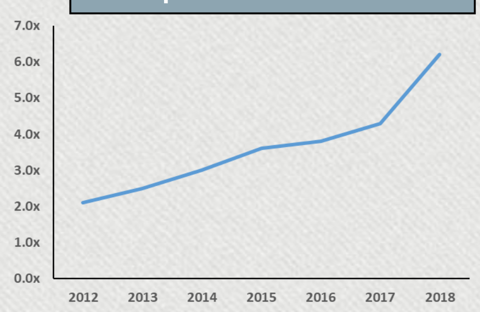
Company / Ticker	3-Year Consensus Revenue CAGR	FY 2018 EBITDA Margin	P/E (NTM)	P/E (FY2)	EV/EBITDA (NTM)	EV/EBITDA (FY2)	EV/Sales (NTM)
Dollar Tree / DLTR	4.3%	12.1%	13.9x	13.4x	9.1x	8.8x	1.0x
Dollar General / DG	7.5%	10.4%	16.3x	16.2x	11.2x	11.2x	1.2x
Big Lots / BIG	0.6%	8.5%	8.7x	8.7x	5.2x	5.3x	0.4x
Five Below / FIVE	21.0%	16.2%	36.0x	41.2x	21.13x	24.3x	3.2x
Canadian Tire / CTC CN	2.0%	9.0%	17.9x	18.1x	8.2x	8.3x	1.0x
Metro /MRU CN	8.0%	7.3%	14.2x	13.9x	9.9x	10.1x	0.8x
MEDIAN	**5.9%**	**9.7%**	**15.2x**	**15.1x**	**9.5x**	**11.0x**	**1.0x**
Dollarama DOL CN	**8.5%**	**25.5%**	**22.9x**	**22.3x**	**16.4x**	**16.3x**	**4.1x**
DOL PREMIUM			**50.5%**	**47.7%**	**72.7%**	**50.9%**	**305.7%**

Does DOL – a value retailer demonstrating concerning fundamental trends – deserve to be valued on par with higher-growth industries, and completely out of line with its industry peers?

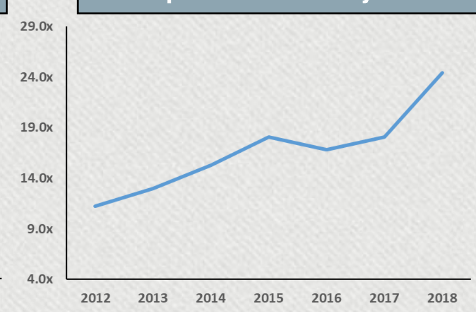
Profitability is impressive, but likely unsustainable in the face of growing competition.

DOL shares also trade at a significant premium to historical multiples despite unsustainable margins, an increasingly saturated market, and rising competitive threats

Enterprise Value / Revenues



Enterprise Value / Adj. EBITDA



Price / Adj. EPS

Does The Market Think Dollarama Is A Dollar Store Or A Premium Retail Brand?

Dollarama is valued much more closely to premium retail brands than its discount retail peer group. A bull might "justify" this by pointing to Dollarama's profitability profile and growth expectations, but its EBITDA margins are so out of line with those of its peers that one is forced to question whether they are sustainable (at best) or honest (at worst). As discussed, Dollarama's consensus sales growth numbers also ignore looming fundamental threats to the business.

Company / Ticker	Gross Margin (NTM)	EBITDA Margin (NTM)	Sales Growth (NTM)	EV/EBITDA (NTM)	P/E (NTM)	EV/Sales (NTM)
Dollar Tree / DLTR	31%	11%	2.8%	9.1x	13.9x	1.0x
Dollar General / DG	31%	10%	8.9%	11.2x	16.3x	1.2x
Big Lots / BIG	41%	7%	-0.8%	5.2x	8.7x	0.4x
Five Below / FIVE	36%	15%	20.3%	21.13x	36.0x	3.2x
Canadian Tire / CTC CN	34%	12%	4.0%	8.2x	17.9x	1.0x
Metro /MRU CN	19%	7%	8.8%	9.9x	14.2x	0.8x
MEDIAN	**33%**	**11%**	**6.4%**	**9.5x**	**15.2x**	**1.0x**
Dollarama DOL CN	**40%**	**25%**	**9.9%**	**16.4x**	**22.9x**	**4.1x**
DOL PREMIUM				**72.7%**	**50.5%**	**305.7%**

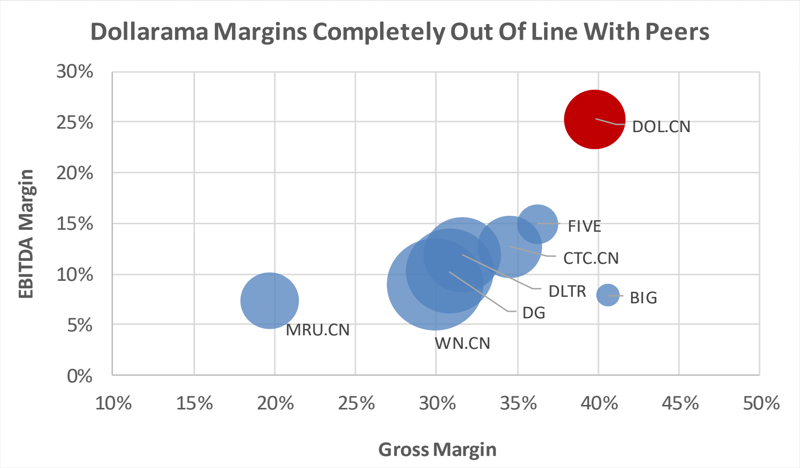
Company / Ticker	Gross Margin (NTM)	EBITDA Margin (NTM)	Sales Growth (NTM)	EV/EBITDA (NTM)	P/E (NTM)	EV/Sales (NTM)
Ferragamo / SFER IM	65%	17%	4.8%	16.0x	26.0x	2.6x
Hermes / RMS FP	69%	38%	8.4%	20.0x	35.0x	7.8x
Prada / 1913 HK	74%	22%	7.8%	10.0x	21.0x	2.3x
Tiffany & Co. / TIF	64%	24%	5.1%	11.3x	19.6x	2.8x
MEDIAN	**67%**	**23%**	**6.5%**	**13.7x**	**23.5x**	**2.7x**
Dollarama DOL CN	**40%**	**25%**	**9.9%**	**16.4x**	**22.9x**	**4.1x**
DOL PREMIUM				**19.7%**	**-2.6%**	**51.9%**

How does Dollarama support EBITDA margins more than double those of its peer group, and in line with premium global retail brands?

Does a discount retailer facing fundamental headwinds deserve to be priced 50% or more above its peer group, and closer to global premium retail brands?

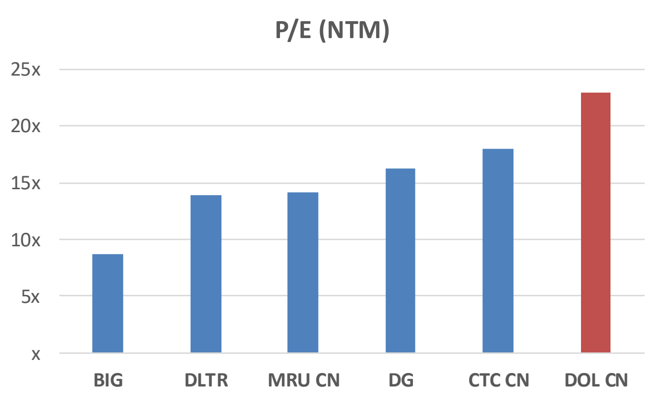
Margins And Multiples Materially Out-of-Line With Peers

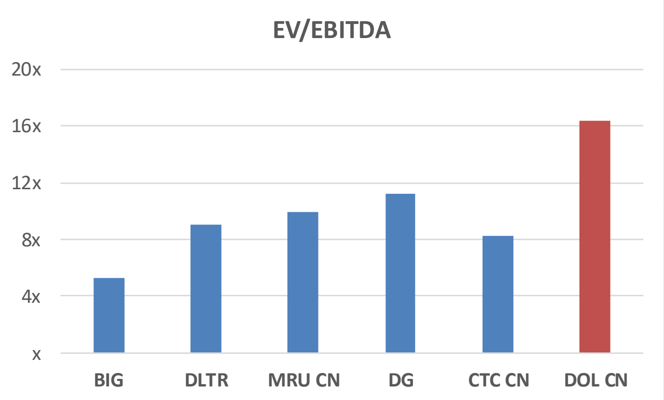
We do not believe that Dollarama's profitability levels – which are entirely out of line with peers – are justified or sustainable in an industry as competitive as deep discount retail. The Company is already struggling to meet store count growth targets, raising the likelihood that its store growth plan will be dilutive to margins. The market assigns a premium valuation to Dollarama on the basis of relatively high growth expectations and the Company's industry-leading margins. However, as discussed throughout this report, we doubt both management's ability to meet its growth targets and its ability to maintain prevailing profitability levels. The likelihood that the Company will be able to achieve *BOTH* of these goals simultaneously is even slimmer. Accordingly, we believe that the basis for Dollarama's substantial share price premium is unfounded.



Dollarama's margin profile is grossly out of line with peers, and we find evidence of aggressive accounting and questionable business practices that can partly explain the issue. We doubt that this would be sustainable even if management wasn't growing the chain.

How will a low/no-moat business with falling per-store traffic be able to maintain its remarkable profitability advantage while aggressively expanding its store base?





The premium in Dollarama's share price is driven by the market's trust in management's growth initiatives and its recognition of the Company's dominant profitability.

However, neither its profitability advantage nor its growth prospects are sustainable. The likelihood that management simultaneously preserves *BOTH* is extremely low.

Big Lots (BIG), Dollar Tree (DLTR), Dollar General (DG), Metro Inc (MRU CN) and Canadian Tire (CTC CN).

Spruce Point Capital Management

Valuing DOL As A Mature Business In The Canadian Market: ~40% Downside

As discussed earlier, at 1,700 stores, DOL would have greater penetration than both Dollar General (DG) and Dollar Tree (DLTR), which both offer a much broader assortment of goods including perishables/consumables. Meanwhile, the U.S. appears to be overstored versus Canada. It is likely unreasonable for DOL to target per capita penetration levels on par with its U.S. peers.

	DOL CN	DG	DLTR
Stores	1,700	14,760	14,732
Population (M)	36	326	326
Stores/Capita (M)	47.2	45.3	45.2

Achieving management's 1,700 store target would put DOL at a higher per capita penetration level than U.S. peers

Store Count by Region

	Canada	US	Can/US Ratio
WMT	410	5,358	7.7%
DOL – Present	1,178	14,750	8.0%
DOL – Future	1,700	14,750	11.5%

Higher Canada store count vis-à-vis comparable US store count compared to Walmart

Store Count per Mil. People by Region

	Canada	US	Can/US Ratio
WMT	11.4	16.4	69%
DOL – Present	32.7	45.2	72%
DOL – Future	47.2	45.2	104%

Higher Canada store concentration vis-à-vis comparable U.S. store concentration than Walmart

C$, MM, unless otherwise noted	Current Run-Rate Valuation	Priced Beyond Perfection	Reasonable Downside
Stores	1,170	1,700	1,500
Revenues/Store	2.8	3.2	3.0
Revenues	3,320	5,440	4,500
Operating Margin	23%	22%	18%
Operating Profit	764	1,197	801
Interest Expense	42	50	50
Tax @ 27.5%	198	315	207
Net Income	523	831	544
Shares	332	332	332
EPS	$1.58	$2.51	$1.64
Multiple	24x	16x	~15x
Share Price	**$38.45**	**$39.66**	**$24.60**
Upside (Downside)		**3%**	**Approx. -40%**

Downside Run-Rate Operating Margin Estimate

Profitability/Cost Measure	Justification	
Gross Margin Target	***Recent Historical Average***	**37.0%**
Current SG&A	*Recent Historical Average*	16.7%
Add:		
Advertising Expense Normalization	*Industry Average*	0.5%
Rent Expense Normalization	*Adjusting for Depreciation Rearranged from Rent Expense*	0.5%
Depreciation Catch-Up	*Matching D&A schedules*	1.5%
Pro Forma SG&A		19.2%
Pro Forma Operating Margin		**17.8%**

Even if we assume that DOL can reach similar penetration levels *and* match company growth targets – with steady margins no less – DOL has little upside.

Valuing DOL as a mature business at its upper penetration bound implies ~40% downside in a more realistic, yet still generous scenario in which DOL is valued in line with peers.