# 4 Reasons Why Dollarama Will Continue to Expand Rapidly

## Description

If you were to ask management of Canadian discount retailer **Dollarama** (TSE: DOL) how the company has achieved annual sales of $1.9 billion and a market capitalization of $5.3 billion, they might well respond with a version of the following and a straight face: one dollar at a time.



Dollarama is having a stellar year: annual revenue increased in the low double digits from the prior year, quarterly net profit growth has clocked in at more than 10% for the last several quarters running, and the company's stock has soared 26.2% so far this year. Much of this success can be traced to the company's aggressive store opening schedule. In the trailing 12 months ended May 5th of this year, total store count grew more than 12%, from 721 stores to 806 locations. The following four factors should enable Dollarama to continue to expand at this pace for the foreseeable future.

**Plenty of room to grow: just look at the U.S.**

In Dollarama's most recent annual report, management estimates that dollar store penetration per capita among the top five Canadian dollar stores is less than half that of the U.S. In the States, there's a dollar store for every 14,000 people, while in Canada the ratio is one dollar store for every 29,000 people. Management believes there is room for both the industry and Dollarama to expand in Canada. This may be so for a very long time, as at least one U.S. retailer, **Family Dollar**, apparently believes that the dollar store landscape will absorb an even higher density: it's going to triple its store count in the U.S., from 7,800 to over 23,000, in the coming years.

**An impressively short payback period**

Because Dollarama's stores boast a relatively small average footprint of under 10,000 square feet, and require a modest capital investment of only $1.4 million, the payback period on a new store is approximately two years — a fairly quick return. Such a short payback period means that the company can continue to aggressively launch new locations, as it does not have to wait several years in each geographical region to see if its investments are panning out.

**Relatively little debt on the books**

One benefit of enjoying a quick payback period is the free cash flow generated by stores in a short period of time. This cash flow has enabled Dollarama to expand without over-leveraging its balance sheet. As of its last fiscal quarter, the company had only $264 million of long-term debt on its books, carrying a fairly lean debt-to-equity ratio of 27.2%. Being conservative with debt thus far will enable Dollarama to use a bit more leverage to increase the pace of store openings if it chooses in the upcoming fiscal years.

**Multiple price points**

In 2009, Dollarama extended past the literal "dollar" price per item, and last year, in July, the company introduced price points for various items up to $3.00. This flexibility of pricing increases the potential range of merchandise offered, and customers have responded positively. Items priced above $1 now make up more than 50% of company sales. "Higher ticket" items should positively impact gross margin as well going forward.

**One risk to be aware of**

Dollarama's greatest risk in expansion might be the Canadian economy's eventual return to growth. Once disposable income increases, will consumers still throng to the familiar green dollar symbol? As **Wal-Mart** redoubles its effort to attract Canadian consumers, and **Shoppers Drug Mart** (TSE: SC) boosts its shelf items due to its merger with **Loblaw** (TSE: L), and as newcomers such as **Target** fight for their share of the average Canadian's wallet, consumers may decide to trade up to better known, branded products. It will be interesting to see what type of strategy Dollarama employs to keep its customers in a rising economy — after all, it can only discount its goods so much further.



**Three U.S. stocks every Canadian should own**

As we saw above, Dollarama has taken some business cues from American dollar stores. While Canada has its own share of great companies, it makes sense to diversify your portfolio, and our neighbors to the south offer some compelling opportunities. That's why The Motley Fool has put together a Special **FREE** Report, "**3 U.S. Stocks Every Canadian Should Own**." The funny thing is, these stocks might as well be Canadian … because you use them every day. Just **click here** to receive your copy at no charge!

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1. Investing

**TICKERS GLOBAL**

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