Still Plenty of Growth Ahead for Dollarama

Description

About once a fortnight, my girlfriend will announce she needs to take a trip to **Dollarama** (TSX:DOL). Usually she'll just stop in on her way home from work, but sometimes we'll go and browse the aisles together. Usually, we end up buying more than what we wanted — and yet we still walk out with change for a $20.

While the store has expanded its merchandise beyond the everything for a dollar concept — with prices up to $3 — items are still cheap enough that customers don't think twice before throwing them into their carts.

That's the whole appeal of Dollarama, fueling growth from a single store in a Quebec mall in 1992 to the more than 800-location behemoth it is today. As the wage gap grows between rich and poor Canadians, Dollarama is well positioned to serve lower income customers. Stores are also often frequented by wealthier Canadians too, who view the cheap merchandise as disposable. It's a nice place in the market to be.

Dollarama's results continue to impress investors. For the most recent quarter, sales were up 14.2%, same-store sales were up 4.8%, operating margins improved significantly (from 16.7 to 18.9%), and earnings shot up 28%. While the company has warned next quarter's results may not be as robust — thanks primarily to cold weather across much of Canada — the stock continues to head higher. The future indeed looks bright for Canada's only national dollar store chain.

In fact things are looking so bright that it's drawn the attention of its American competitors. In 2010, **Dollar Tree** (NASDAQ:DLTR) acquired Dollar Giant, a small B.C.-based dollar store chain, for $52 million. There were 85 stores at the time of the acquisition, and the chain has grown modestly to 180 stores now. Dollar Giant's management believes they'll eventually open 1,000 stores across Canada. While increased competition isn't good for Dollarama, it is encouraging to see competitors being bullish on Canada's potential.

An analyst from Credit Suisse estimated that Canada has room for 1,700 additional dollar stores long term, although an additional 400-700 would be more realistic in the short term. Dollarama has already announced plans to increase the number of locations by approximately 120 over the next 12-18 months, increasing store count by approximately 15%.

Even after all this growth, Dollarama still has a solid balance sheet. Debt is still a very manageable 20% of assets, there's a reasonable cash buffer, and the company continues to use excess cash to buy back shares, decreasing the float by approximately 5% over the past two years. It also pays out a small dividend, currently at 0.6%.

The stock is a little expensive on an earnings basis, as would be expected with a company growing this fast. The trailing P/E ratio is 26, and while the P/E based on 2015's estimated earnings drops down to just a hair under 21 times, nobody will ever claim Dollarama is a value stock. The company does have the potential to grow earnings significantly over the next few years, which would justify those high ratios.

Foolish bottom line

While Dollarama faces competition from Dollar Tree and price pressure from **Walmart** (NYSE:WMT), there's still plenty of room for expansion in Canada. If things go smoothly and stores continue to deliver solid growth, look for Dollarama to head higher from these levels.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:DLTR (Dollar Tree, Inc.)
2. TSX:DOL (Dollarama Inc.)

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