Dollarama Inc. Falls Over 7% Despite Strong Q3 Results: Should You Buy Now?

Description

Dollarama Inc. (TSX:DOL), the largest owner and operator of dollar stores in Canada, announced better-than-expected third-quarter earnings results before the market opened on December 9, but its stock responded by falling over 7% in the day's trading session. Let's take a closer look at the result to determine if we should use this weakness as a long-term buying opportunity, or if we should wait for an even better entry point in the trading sessions ahead.

The better-than-expected quarterly performance

Here's a summary of Dollarama's third-quarter earnings results compared with what analysts had expected and its results in the same period a year ago.

Metric	Q3 2016 Actual	Q3 2016 Expected	Q3 2015 Actual
Earnings Per Share	$0.78	$0.70	$0.55
Revenue	$664.49 million	$663.97 million	$587.97 million

Source: Financial Times

Dollarama's diluted net earnings per common share increased 41.8% and its revenue increased 13% compared with the third quarter of fiscal 2015. The company noted that its immense earnings-per-share growth could be attributed to its net earnings increasing 37.1% to $100.08 million, driven by increased sales, an improvement in its gross margin, and lower selling, general, and administrative expenses as a percentage of sales.

Its very strong revenue growth can be attributed to two primary factors.

First, Dollarama achieved strong organic sales growth in the third quarter, which was fueled by its comparable-store sales increasing 6.4%, including a 5.4% increase in the average transaction size and a 0.9% increase in the number of transactions, and this was over and above the 5.9% growth it recorded in the year-ago period. Second, the company added 77 stores over the last year, bringing its total count to 1,005 and allowing it to reach more consumers.

Here's a quick breakdown of eight other notable statistics from the report compared with the year-ago period:

1. Gross profit increased 23% to $265.95 million
2. Gross margin improved 320 basis points to 40%
3. Earnings before interest, taxes, depreciation, and amortization (EBITDA) increased 34.8% to $154.81 million
4. EBITDA margin improved 380 basis points to 23.3%
5. Operating profit increased 35.8% to $142.59 million
6. Operating margin improved 360 basis points to 21.5%
7. Repurchased approximately 2.12 million shares of its common stock for a total cost of approximately $188.2 million
8. Opened 16 net new stores during the quarter, compared with 11 net new stores opened in the year-ago period

Dollarama also announced that it will be maintaining its quarterly dividend of $0.09 per share, and the next payment will come on February 2, 2016 to shareholders of record at the close of business on January 7, 2016.

Should you buy Dollarama today?

It was a phenomenal quarter overall for Dollarama, so I do not think the post-earnings sell-off in its stock was warranted. With this being said, I think the drop represents nothing more than a long-term buying opportunity for four primary reasons.

First, Dollarama's stock now trades at just 28.9 times fiscal 2016's estimated earnings per share of $2.83 and only 25.1 times fiscal 2017's estimated earnings per share of $3.25, both of which are inexpensive compared with its five-year average price-to-earnings multiple of 42.2 and the industry average multiple of 29.5.

With the multiples above and its estimated 18.4% long-term earnings growth rate in mind, I think the company's stock could consistently trade at a fair multiple of about 35, which would place its shares upwards of $113 by the conclusion of fiscal 2017, representing upside of more than 38% from today's levels.

Second, Dollarama now has a total of 1,005 locations in Canada, but I think it could easily have over 1,500 by 2025, and I think it could accomplish this without ever running into issues related to market densification.

Third, Dollarama has been actively repurchasing its shares, including 4.19 million shares for a total cost of approximately $335.2 million in the first nine months of fiscal 2016. Also, in the earnings report, the company announced an amendment to its normal course issuer bid in order to increase the number of common shares that can be repurchased.

It can now repurchase up to 6.43 million shares of its common stock, representing approximately 5% of its total public float, between June 17, 2015 and June 16, 2016. These repurchases will help boost its earnings-per-share growth going forward and make its remaining shares more valuable than ever before.

Fourth, Dollarama pays an annual dividend of $0.36 per share, giving its stock a 0.4% yield at today's levels. This minuscule yield may not impress you at first, but it is very important to note that the company has raised its dividend for four consecutive years, and its strong financial performance could allow this streak to continue in 2016.

With all of the information provided above in mind, I think Dollarama represents one of the best long-term investment opportunities in the market today, so all Foolish investors should strongly consider using the post-earnings weakness to being scaling in to positions.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:DOL (Dollarama Inc.)

Category

1. Investing

Date
2025/09/30
Date Created
2015/12/10
Author
jsolitro