Dollarama Inc.: Is it too Late to Invest in Canada's Best Retailer?

Description

I'm going to start this article with a bold statement. I think **Dollarama Inc.** (TSX:DOL) is Canada's best retailer.

There are plenty of reasons to back up my claim. Results from our largest chain of dollar stores have been nothing short of stellar since it became a publicly traded company. Last quarter was no exception.

Total sales were up 14.6%, increasing to $766.5 million. Same-store sales rocketed 7.9% higher. Gross margins increased; so did EBITDA. And most importantly, net income surged 31.6%, going from $0.76 per share to $1.00. The company rewarded shareholders with an 11% dividend increase as well.

Dollarama continues to grow like a weed. The company opened 25 new stores in its latest quarter alone, increasing the store count to 1,030 stores across Canada. Management expects to open between 60 and 70 stores over the next year, and analysts think the company can maintain that pace for years to come.

Dollarama can deliver these kinds of results because of its terrific business model. By focusing on lower-cost items, the company can raise prices to customers without shoppers really feeling the pain that much. An increase in the price of an item from $1 to $1.50 doesn't feel like a 50% increase. It's just a lousy 50 cents.

Like most other retailers, Dollarama felt the pain of Canada's declining dollar; 99% of its products come from China, a country with a currency essentially pegged against the U.S. dollar. But unlike many of its peers, Dollarama was able to pass on price increases to customers. Now that the currency has moved in a positive direction for the retailer, prices will stay higher and increased profits should be the result.

Considering how I've spent the last few paragraphs gushing about Dollarama's operations, its expansion potential, and its terrific business model, you'd think I would be rushing out and buying all the shares I could get my hands on. After all, it's a terrific business, and just about every successful investor preaches about owning good businesses.

There's just one problem: I can't get over the price. Dollarama shares trade at nearly 30 times trailing earnings, an expensive multiple in a market many people think is full of stocks with lofty P/E ratios.

Should investors shrug off the high valuation? Or should they patiently wait for a lower entry point?

Pay up for quality?

Dollarama isn't some tech stock high on hope and low on actual results. It's a very real business that's solidly profitable. Over the last 12 months it has earned $3.01 per share in profits.

The company has also proven that it has a scalable business model. There's no wondering where the growth is going to come from. We can all see the potential, and we can all see a realistic path to get there.

But at the same time, it's obvious the whole market sees the potential, which means investors have to pay a huge premium to get a piece of it. Even if we look at earnings for the company's upcoming year–which are expected to increase to $3.36 per share–that still gives shares an aggressive valuation of 26.5 times forward earnings.

It's easy to make the argument that Dollarama shares are too expensive based on those P/E ratios. And remember, a company doesn't have to seriously stumble for investors to get a lacklustre result. If shares go from an expensive valuation to a reasonable one, investors still lose out.

Analysts expect Dollarama to earn $3.88 per share for the company's fiscal 2018. If shares trade at 22 times earnings at that time (which is still a higher multiple than the overall market), shares would end up down approximately 5% compared with today's levels. That's the real danger in paying for quality.

I can see why investors would be happy to buy Dollarama at today's levels. But for me, I'd like shares to go down before I look seriously at buying the stock.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:DOL (Dollarama Inc.)

Category

1. Dividend Stocks
2. Investing

Date
2025/09/11
Date Created
2016/04/25
Author
nelsonpsmith