Is Dollarama Inc. Still a Good Investment?

Description

The past few years have been incredible for the market; at times, entire segments have posted double-digit gains, particularly over the past year.

Not that I want to burst any bubbles (pun intended), but as the old saying goes, “What goes up, must come down.” And the cracks are starting to form in some areas of the economy, specifically in retail.

Between the ongoing prospect of looming interest rate hikes, continued uncertainty in Washington, and the increasingly worrisome state of consumer debt, the retail sector may be one of the first areas to be hit with an overdue correction.

Dollarama Inc. (TSX:DOL) is viewed by many as one of the most, it not *the* most, successful retailer in the nation. Since going public nearly a decade ago, Dollarama has grown at an incredible pace, sending the company’s market cap shooting up.

That growth has drawn more than a fair share of critics, who have become increasingly vocal over the past few months. Chief among those concerns include the following: Can the current growth cycle continue? Is the dollar-store market too saturated for Dollarama to continue growing at the same pace? How much will Dollarama be squeezed if the loonie continues to slide south?

Let’s look at those concerns in some detail.

Can the current growth cycle continue?

The quick answer to this question is yes, albeit at a slower pace, and there are two reasons for this.

First, despite a slowdown, Dollarama still has a competitive advantage over its competitors. There’s a reason why so many customers flock to Dollarama’s +1,000 locations across the country; it’s because Dollarama sells a greater variety of products that competitor stores, for whatever reason, can’t or won’t sell.

That factor contributes to why it’s so difficult to enter a Dollarama store and emerge with just one purchase.

The second point relates to dollar stores and their overall performance in the economy. Dollar stores are well known for registering a surge in sales as the overall economy cools down. Consumers looking to cut expenses will often start by turning to less expensive outlets and selections, which means more visits and, in turn, more sales for Dollarama.

Dollarama has benefited from this cycle several times over the past few years and will likely continue to do so this time around.

Will Dollarama get squeezed by a weakened loonie?

The loonie's latest flight south has raised long-standing concerns regarding what will happen to Dollarama's margins if the current climate persists.

Most of Dollarama's goods are made abroad and imported, then sold at one of the price points that Dollarama offers (currently capped at $4). When there's downward pressure on the loonie, the buying power that Dollarama has decreases, which forces the company to either add higher price points to recap that lost buying power, order fewer products in each bundle, or some combination of both. Higher price points also allow Dollarama to offer a greater assortment of higher-quality products.

In short, a weakened loonie, over a prolonged time will have some impact over the products Dollarama sells, but the company can counter this with relative ease, and customers will continue to flock to its stores.

Is Dollarama a good investment?

In my opinion, Dollarama remains a good investment over the long term, provided investors look at the opportunity that Dollarama represents in the context of the entire economy moving forward and not based on past performance, as it may grow at a slower pace.

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