You Should Avoid Dollarama Inc. for These 2 Reasons

Description

Dollarama Inc. (TSX:DOL) has seen its stock soar this year as its price has increased over 26% in value in the past 12 months. The company saw its stock jump by over 11% after it released its fourth-quarter results back in March of this year, and it continued its climb to $120, where it has been able to find support.

However, there are some big reasons to be concerned about the stock. Here's why it would be a good idea to avoid it as a long-term investment.

Dollarama is vulnerable to cost increases as a result of minimum wage hikes

Dollarama has almost 1,100 locations across Canada with its most significant presence in Ontario. In total, 641 of its stores are located in Alberta, Ontario, and British Columbia — all provinces that will see minimum wages rise to $15 within the next four years. Alberta will see a wage hike as early as next year, while Ontario's rate will rise in 2019.

For Dollarama, this will have a big impact, as it will see its employee costs increase significantly. In Ontario, this will mean an increase in wages by over 31% from the current minimum rate of $11.40. British Columbia's rate hike will be the biggest, as the province's hourly rate of just $10.85 will need to rise by over 38% to reach $15. Alberta's current minimum wage of $12.20 will have the smallest increase, but costs will still rise by 23%.

What this will likely mean is that Dollarama will have to raise its prices yet again. The retailer already has many items that are well over a dollar, and with increased costs, the bargain store will likely be forced to increase its prices even further. From an investor's point of view, I wonder if customers would continue go to Dollarama if prices reach higher levels; at what point will a customer just opt to go to other retailers?

If Dollarama's deals do not appear to be as good, it may lose its advantage in the marketplace. Dollarama's low-cost business might be impacted by minimum wage hikes more than other companies since it is the most likely to be being paying its staff minimum wage.

The stock is already overvalued

In the past 12 months, Dollarama's earnings per share have totaled $3.85, and at a stock price of over $123, that means shares are trading at over 31 times earnings. This is a hefty premium, even for tech companies, let alone for a company that's subject to the problems and competition of the Canadian retail industry.

One way to normalize the price-to-earnings ratio is to calculate the PEG ratio, which divides price-to-earnings by the company's average growth. With sales of $2.9 billion in its last fiscal year, Dollarama has seen sales increase by over 43% in three years for a compounded annual growth rate of 13%.

With a price-to-earnings multiple of 31 and a growth rate of 13%, the PEG ratio would yield a total of 2.3. An acceptable ratio is under one, which, in this case, means that Dollarama is trading at a big premium for the amount of growth it has been able to achieve.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:DOL (Dollarama Inc.)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Dividend Stocks
2. Investing

Date
2025/09/02
Date Created
2017/08/22
Author
djagielski