

## Were Dollarama Inc.'s Earnings Really That Good?

### Description

On the surface, investors who've owned shares of **Dollarama Inc.** ([TSX:DOL](#)) have made out very well given the company's increase in value by more than 10% following its second-quarter results. At face value, things seemed fantastic: revenues increased by 11.5%, and earnings per share (EPS) increased by 30.7%, while the total number of new stores increased by a healthy 7%.

Given that the increase in revenues exceeded the increase in stores, it is clear that each store sold a greater amount of merchandise than it did one year ago. Although the top and bottom lines have both increased substantially, it has never been more critical for investors to remain cautious and conduct additional due diligence to ensure that the EPS are, in fact, fairly reflective of reality.

For the second quarter of 2016, the EPS came in at \$1.16, which is a 30% increase from the previous years' amount of \$0.89. The caveat, however, is that from one year to the next, the total number of shares outstanding has declined substantially due to the company's overzealous share-buyback program. The total number of shares outstanding declined from 119.4 million to 113.3 million shares. The company shrank the equity component of the capital structure by 5.1% and increased the amount of debt by \$400 million over the past six months. Backing out the share buyback, the company may only have made EPS of \$1.10 depending on the timing of the repurchases.

As the amount of leverage has increased, the company's return on equity (ROE) will much more easily trend upwards, making the company more attractive to shareholders seeking high ROE. The downside, however, will be a greater amount of interest expenses, and now with higher rates, the cost to fund this debt will also increase.

While the company continues to increase the size of its stores and sell higher-priced and higher-margin items, the growing pains may create a disconnect between the company and customers. What was traditionally a dollar store has become a retail outlet which now sells many items that cost several dollars. Eventually, customers will catch on and begin doing comparison shopping at other stores.

While the results of the well-run Dollarama are excellent, how will the company increase top- and bottom-line growth in the future? With what are now very high comps to look back on, the law of large numbers will eventually come into play, and the buyback train will have to be parked in the station (probably sooner rather than later). Although the company has performed very well in the past, the reality is that many of the things that could be stretched to create value have now been done. An example of this is the debt, which has been taken on to fund the share-buyback program.

Although Dollarama is one of the best run companies in Canada, the reality is that investors must ask themselves what they are paying and what they are getting. In this case, the proposition may not make all that much financial sense for all investors.

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