Dollarama Inc.: Do Q2 Results Make it a Buy?

Description

It has been an amazing ride for investors of **Dollarama Inc.** (TSX:DOL) since the company went public back in 2009. The stock has appreciated by 1,332%, which is truly an amazing return on investment. And along the way, the company has been consistently boosting the dividend with six consecutive years of dividend increases. Dollarama is no dividend juggernaut, but dividend increases are always appreciated.

Dollarama recently released its Q2 2018 results, and they were incredibly strong, pushing shares up over 13% in the days that followed the release. The question we must ask is simple: Do these results make the stock a buy, or is it already too overpriced?

The company did $812.49 million in sales, up 11.5% from a year earlier. Dollarama's operating income was up 24.1% to $191.91 million, in part because of a 240-basis-point improvement in operating margin. Further, it expanded its number of stores from 1,051 to 1,125 and boosted its compared store sales growth by 6.1%. The reality is simple: Dollarama is executing incredibly well.

Dollarama *also* provided an enhanced guidance, demonstrating even greater potential growth. It will add an additional 60-70 stores and expects to see the EBITDA margin of 22.5-24%, up from 22-23.5% in the original guidance. Although capital expenditures are going to be slightly greater, the margin should offset that.

This growth is necessary, because if it can continue to generate strong comparable store sales growth while also adding new stores to its portfolio, sales will continue rising. And if it can keep its margins as strong as they are, earnings (and dividends) should continue to grow.

So, the company is obviously a buy, right? Not exactly…

All of this growth comes at a cost. The company currently sits on $1.4 billion in long-term debt, which increased from $1.27 billion as of January 29, 2017. To make matters worse, the shareholders' equity is currently a $59,388,000 deficit, which means that, technically, shareholders owe money. A year ago, debt accounted for 56% of Dollarama's assets; now it's 78%.

On top of that, financing costs continue to rise. Last year, the company spent $7 million in the quarter, but this year, that had grown to $10 million. Although it is not a significant amount of money, as the company continues to expand, these financing costs are going to grow. And, if interest rates rise much higher, the financing costs could become a burden on Dollarama.

We need to decide if Dollarama can grow faster than its debt obligations, thus allowing the company to pay it off. We've seen many fast-rising stars that used debt to pave the way inevitably crater.

Here's where I stand: it has been an amazing journey for Dollarama, and that journey doesn't appear to be slowing. So long as the debt remains manageable, this stock should continue to rise. And based on expected earnings per share, it is not terribly overpriced. Nevertheless, you have to accept there are risks associated with owning Dollarama. Investors are ecstatic with the amount of growth this company has experienced, but it will need to execute flawlessly if that growth is going to continue.

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