5 Reasons to Buy and 5 Reasons to Sell Dollarama Inc.

Description

I have been watching **Dollarama Inc.** (TSX:DOL) for two years. Like others, I am impressed (read: marveled) with the ability of this company to churn out profits by selling small-price-tag items. This nimble $16 billion company is unencumbered by property management challenges, since it leases retail spaces. Retail real estate giant **RioCan Real Estate Investment Trust** is one of Dollarama's more common landlords.

Dollarama stock has moved up aggressively in the last two months. Most of the move was three big days, like the 10% gap up on Sept 7 after the company reported on the second quarter. Here is a look behind some of the numbers; both headwinds and tailwinds are provided.

Tailwinds

1. Dollarama has outpaced its competitor south of the border, **Dollar Tree, Inc.**, by two-fold on stock price over the last five years.
2. Dollarama does not have e-commerce footprint; it relies on foot traffic for sales, which could be viewed as a problem for business. But in the recent quarter, the company reported increased foot traffic — a positive sign compared to other retailers, where traffic has dropped.
3. Dollarama's comparable sales growth increased from 5.7% in 2016 to 6.1% in 2017. This was one reason why the stock price shot up.
4. Introducing credit card payments in 2017 has been a winning strategy. The company stated that sales from credit card payments are typically two times cash purchases.
5. The recent quarter was another example of growing operating margin, which is the operating income divided by sales. This number was 21% in 2016 and it increased to 24% in 2017.

Headwinds

1. Dollarama went from 1,051 stores in 2016 to 1,125 stores in 2017. Adding stores will eventually add revenue, but the company is forecasting lower comparable sales growth for 2018.
2. The last time the forward price-to-earnings ratio (forward P/E) was this high at a multiple of 30 was back in 2015, which is coincidentally the time that the stock corrected and dropped 20%; in so doing, this made the forward P/E revert back to the five-year average of ~24 times. If history repeats, a pullback could happen in 2018.
3. The five-year average earnings per share (EPS) is 26% per year. In the last two years, the annual EPS have had increases of 21% and, more recently, 18%. During these equivalent periods, the stock price increased 13% and 36%. That's right; the year-over-year stock price was twice the EPS growth. Expectations are high.
4. Dollarama has 449 stores in Ontario, a little under half of all stores. Ontario's increase in minimum wage could happen as early as January 2018, which could be a modest headwind. In the last quarter, total sales were $812 million and the cost of sales (which would include salaries) was $490 million.
5. After years of low debt relative to equity, Dollarama's debt is up considerably in 2017. The net

debt as of July 2017 was $1.4 billion, twice as high as it was two years ago.

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