Dollarama Inc.: Can the Growth Just Keep Coming?

Description

Since the beginning of the year, **Dollarama Inc.** (TSX:DOL) has appreciated by 48%, which is an incredible return. But when you look at when the company went public back in 2009, the stock has appreciated by 1,392%. Let that soak in a little. Peter Lynch, one of the most famous investors, called a 10 times investment a 10-bagger. And Dollarama is a few hundred percent ahead of that!

But anytime a company experiences that sort of appreciation, you're left wondering if there's more coming. Or, as fellow Fool writer David Jagielski suggested, is this the peak? Let's take a look to try and determine the future prospects.

In Q2 2018, the company did $812.49 million in sales, which was up 11.5%. Diving deeper, comparable store sales grew by 6.1%, which is accelerated compared to the 5.7% growth the previous year. And finally, it had 17 net new stores compared to 13 net new stores during the same period last year. Essentially, you've got a company opening new stores, expanding same-store sales, and thus generating a huge boost in total sales.

On top of that, the gross margin was 39.6% of sales compared to 38.4% of sales in the previous year. This, in part, contributed to the 24.1% growth in operating income to $191.9 million. Last year, operating income accounted for 21.2% of sales, whereas this year it's up to 23.6%.

What you've got is a business that continues to grow incredibly fast, both in new store launches and also in sales growth in the current network. Along the way, Dollarama is generating even greater margins. Talk about an amazing business. And with the company looking to launch an additional 60-70 stores over the coming quarters, Dollarama's total sales should continue growing.

With all that said, there are two concerns investors might have.

The first, which Fool writer Stephanie Bedard-Chateauneuf discussed, is that the increasing minimum wage in Ontario could offset total earnings. This is a common theory, but there is also a theory that as these workers increase their earnings, they're likely to spend it in the same store they work. So, I'm not all that concerned about minimum wage increases.

The second concern is debt. The company is sitting on $1.4 billion in debt, which increased from $1.27 billion in the beginning of the year. A year ago, debt was 56% of the company's assets; now it's 78%. Then there are financing costs, which are on the rise. Last year, it spent $7 million in the quarter — it's now $10 million.

Should this concern you? Not right now. The growth seems to be outpacing the growth in financing costs, so all the borrowing is worth it. However, if sales start to slow, these financing costs could cut into the company's margins.

There are some that would argue that physical retail is dying. I don't think that's a problem, and I believe the types of products that Dollarama sells are not likely to be disrupted by the major ecommerce players. Will sales continue growing like they are now? Not likely. But for the time being, there's a lot more growth to come and, along the way, you can earn a quarterly dividend of $0.11.

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