Should You Buy Dollarama Inc. Ahead of Earnings?

Description

Dollarama Inc. (TSX:DOL) has had a very strong year on the TSX in 2017 with returns totaling more than 50% year to date. The company continues to grow as other retail stores struggle with costs continuing to rise, and competition with online retailers becoming fiercer.

Loblaw Companies Ltd. (TSX:L) recently announced that it would be closing 22 stores and launching a delivery service, so it can rival its competition. Meanwhile, Dollarama continues to see its sales grow, as the company opens more stores.

Is Dollarama immune from the challenges that other retail companies face?

It would certainly seem as if Dollarama plays by a different set of rules; it's almost as if it's in a different industry. The company will be impacted by rising minimum wages that are happening in multiple provinces, but its low-cost business model enables the company to be flexible.

Dollarama's business model allows it to carry a more limited range of items and occupy a smaller space than other big-box stores, which helps the company keep its overhead low. Consumers that go to Dollarama are going there to find the cheapest deal, not to find a wide selection of items or to spend a lot of time going around the store.

Dollarama has a strong track record of beating earnings estimates

The company has normally done well on earnings day, and for the past 12 quarters, its earnings per share have come in above estimates. However, beating estimates isn't always enough to see the share price rise, as other factors can impact which direction the stock goes.

When the company reported a strong Q2 back in September, its share price jumped more than 10% on earnings day. Although Q1 didn't give Dollarama much of a boost, Q4 results saw the stock rise 11% as well.

Why the stock might not be a good buy

Dollarama's stock trades at 36 times earnings, and it is at an all-time high. The trajectory the stock has been on is incredible, and in five years the share price has grown 370%. It may be hard to see how the stock can continue to grow at this pace without cannibalizing existing store sales.

In the long term, I would be weary of buying Dollarama given that the company still relies heavily on new store openings and higher average purchases fueling its growth.

Why the stock might be a good buy

In the short term, there are still many opportunities for Dollarama to continue to grow. As housing and other costs increase, more consumers will look to dollar stores to try to stretch their incomes as much as possible.

The company has done a good job of finding ways to continually grow sales, and it has shown no signs of slowing down with growth normally in the double digits. By carrying a limited selection of items, Dollarama also has a lot of flexibility with suppliers and its product offerings.

The company can make purchase decisions that are the most cost effective, rather than having to ensure that a certain brand is carried by the store to appease its customers.

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