Dollarama Inc. Posts Strong Q3 Results But Future Growth Might Be Limited

Description

Dollarama Inc. (TSX:DOL) released its third-quarter results on Wednesday, which showed strong sales growth for the dollar store. Sales of over $810 million were up 10% from the prior year, which is a little less growth than the company recorded in Q2.

Profits of $130 million for the quarter were up an impressive 18% year over year, but also lagged the strong 24% growth the company achieved in the previous quarter.

Despite another strong quarter, investors were unimpressed, as the stock dropped 2% by the end of trading on Wednesday. Let's take a closer look behind the results to see why that might have been the case.

Sales growth has started to slow

Comparable store sales growth in Q3 was 4.6%, down from 5.1% a year ago and less than the 6.1% growth the company achieved in Q2. However, the number of transactions rose by just 0.1% as Dollarama's sales continue to be fueled by customers spending more per transaction — a trend we saw in Q2 as well.

We may see the transaction size continue to grow, as more consumers do more of their shopping at Dollarama, while housing and other costs continue to rise, forcing consumers to find ways to stretch their budget and find savings.

Much of the company's growth has come in the way of opening new locations. Since last year, Dollarama has added 66 stores in the past year, bringing its total as of the end of Q3 to 1,135. The company is on track with its guidance to add between 60 and 70 stores in fiscal 2018 and expects to add a similar amount in fiscal 2019 as well.

Unfortunately for Dollarama, because it is a growth stock, it will be evaluated as one. Simply growing might not be enough for investors, and seeing a slowdown in its rate of increase might be cause for concern.

New competition could pose a risk to the company's growth

Miniso Canada, a growing Asian-based dollar store, has opened several locations in Canada and expects to have between 30 and 50 stores open by the end of 2018. The range of price for the majority of its products is between $2.99 and $5.

Miniso sells electronics, health and beauty, stationery, accessories, and home necessities. These are very comparable items to what you would find in a Dollarama and could pose a serious threat to the company's growth.

Dollarama's CEO, Neil Rossy, did his best to try and downplay the risk from Miniso, stating, "We consider them a pure China-based, Chinese import dollar store."

Many of Dollarama's products ironically come from China, and a big reason why shoppers buy from Dollarama is that brand names are not that important, which is what makes Miniso's lower-cost model a big threat. Rossy conceded that "they do a very nice job in stores about one-quarter to one-third the size of ours."

While that might be a shot at Miniso's cramped store size, smaller stores result in lower overhead costs and can help the company offer lower prices.

Should you buy Dollarama?

Dollarama has a lot of debt on its books, and with growth slowing and the company seeing more competition, it could be a recipe for disaster. I've thought Dollarama has been overvalued for some time, and these results do nothing to change that.

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