Dollarama Inc. Down 6% From All-Time High: Time to Buy?

Description

Holding shares of **Dollarama Inc.** (TSX:DOL) has been an incredible investment for those that got in even a year ago. And for those who have been holding for five years, you're sitting on a 431% return. But what if you missed this story entirely? With shares pulling back 6% from their all-time high, should you be looking to buy?

Dollarama is an incredibly hot company primarily because it's been growing hand over fist, opening multiple new stores every quarter, thus boosting its sales and earnings quarter after quarter. And that growth continues to be addictive.

The company reported its Q3 earnings in December, which ended right before Halloween. Dollarama reached $810.6 million in sales, up 9.7% from the same quarter as last year, in part because the average customer spent 4.5% more per transaction. Same-store sales, which are indicative of current stores remaining successful, rose by 4.6%.

Nevertheless, when growth is addictive, analysts expect the world. Analysts had expected $824.9 million in sales and a 6% increase in same-store sales, so Dollarama didn't deliver on analyst expectations.

One reason that sales weren't as high as analysts expected is that Dollarama only opened 10 new stores in the quarter, whereas in the third quarter last year, the company opened 18 stores. If the company is not opening stores, can growth continue coming?

Management isn't too concerned. Dollarama intends on opening 60-70 stores this year and next year, so the company is going to have plenty of new retail locations to sell. Over the next decade, management expects opening up to 1,700 stores across Canada.

Lest we forget, the margin on these goods is actually very good. In the quarter, gross margin was 40.1%, up from 39.5% from a year ago. This contributed handsomely to the $1.15 per share in profit, up from 25% last year. And that did beat analyst expectations by $0.04.

Should you be buying? There are two schools of thought here.

Fellow Fool writer Joey Frenette believes that the stock is far too expensive and doesn't justify its price. He argues that "most of the future earnings growth is already baked into the stock." He goes on to explain that with optimism so high (addictive even?), that one bad quarter could send this stock plummeting.

He's not wrong. Dollarama is entirely dependent on delivering strong quarter-to-quarter results. And to do that, it needs to continually open new stores and keep its same-store sales up. If it starts to falter, investors are going to be in for a rude awakening.

My thought process for Dollarama is actually quite simple. The company is operating efficiently, though it’s certainly overpriced. A 6% dip from all-time high might be an okay place to buy, but I’d be looking for a deeper dip to pick up shares. And if you don’t get in on Dollarama, that’s okay. It’s important not to fall in love with the stock and view it through clear lenses. There are plenty of other companies worth investing in.

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Date
2025/08/18
Date Created
2018/02/20
Author
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