3 Problems in Dollarama Inc.'s Q4 Earnings That Investor's Shouldn't Ignore

Description

Dollarama Inc. (TSX:DOL) released its fourth-quarter results on Thursday, which again showed impressive growth. Sales were up 10% from last year, and the company's earnings have grown by more than 11%, as Dollarama continues to prove that it's not just another retail stock.

However, there are three items that investors should consider before deciding whether to invest in the stock today.

New stores continue to fuel growth

While Dollarama's double-digit growth is impressive, it is down from the 11.5% increase that the company achieved last year. For the full year, Dollarama's sales have increased by 10% compared to 12% in fiscal 2017. Comparable-store growth of 5.5% this quarter was also down from 5.8% a year ago.

A big reason behind the sales growth: new stores. As of the end of Q4, Dollarama had 1,160 stores, which is 65 more than it did this time last year. The inevitable problem is that Dollarama will eventually come to a level of saturation where it won't be able to keep opening stores at this pace, and if same-store sales aren't able to grow, then we'll see revenues decline even further.

Debt levels continue to rise

Rising debt has been a persistent issue for Dollarama, and we've seen it increase yet again. At the end of Q4, Dollarama's total debt had reached $1.67 billion, which is up 25% from last year. The obvious problem here is with interest rates on the rise and the potential for even more hikes this year, Dollarama could see its interest costs continue to increase, and coupled with lagging sales growth, there could be some real problems down the road.

The company raised its dividend, but why?

In its release, Dollarama raised its dividend by 9% and will now be paying investors $0.12 per share for a dividend yield of less than 1%. Although dividend hikes are normally welcome announcements in the investment world, and I understand that Dollarama wants to stay consistent with its increases, I believe the money could be better used to pay down debt or to fund growth.

After all, with a tiny yield the stock isn't going to be attracting many dividend investors, as Dollarama is mainly a growth play at this point. If a company isn't paying at least 2% in dividends, I think it's better off using that money to either reinvest in the business or pay down its liabilities.

To me, it's a sign of inefficiency, and while growth investors will be happy to take the nominal payout, it's not likely to have a big impact on whether investors decide to buy the stock or not.

Bottom line

After a strong 2017, Dollarama's stock hasn't been able to sustain any momentum so far this year. However, the positive results could fuel the share price, and the stock did get a boost from the positive news on Thursday.

While there are concerns about the company over the long term, it is still one of the better retail stocks in the industry. **Loblaw Companies Ltd.** (TSX:L), for instance, is facing many issues this year, while also trying to figure out how to keep sales growing, and it's what many would consider to be a blue-chip stock.

Dollarama is a good buy, and the stock is a better buy than its peers, but there are warning signs that investors shouldn't ignore.

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