Better Buy: the TSX vs. Dollarama Inc.

Description

Many investors believe that it is better to be diversified regarding investments rather than owning only a few stocks, because diversification reduces risk. For that reason, some investors prefer to invest in the whole market by buying an ETF that replicates its composition, rather than pick individual stocks.

Then there are investors like Warren Buffett, who prefers to be concentrated in a few positions and has been able to beat the market by a wide margin over many years.

That means it can be preferable to buy one stock as opposed to the whole market depending on the stock. Let's compare the TSX to **Dollarama Inc.** (TSX:DOL), a popular retail stock that has performed very well, to determine which one is a better buy now.

A big difference in performance

The **S&P/TSX Composite Index** (TSX:^GSPTSE) hasn't produced high returns. Its five-year, three-year, and one-year compound annual returns are 7.2%, 3.4%, and 0.3%, respectively.

Since the beginning of the year, the TSX has dropped by 5.6%. The TSX has been dragged down by the energy sector, which fell despite rising oil prices. The energy sector accounts for a large portion of the TSX with a weight of almost 20%. As the energy sector is sensitive to economic cycles, that makes the TSX rather risky.

The consumer discretionary sector accounts for only 6% of the TSX. While Dollarama is considered part of this cyclical sector, this stock doesn't behave like a cyclical stock. As this retailer sells a variety of everyday items for $4 or less, consumers will shop there during any season and regardless of the economy. You can find just about anything at Dollarama, ranging from kitchen articles to office supplies to non-perishable food.

The stock has performed very well and outperformed the TSX by a wide margin since its IPO in 2009, driven primarily by strong growth in earnings that have consistently beaten analysts' expectations. Its five-year, three-year, and one-year compound annual returns are 37.0%, 29.9%, and 42.3%, respectively.

Year to date, the share price is down -1.3%, but it rose by 5% on March 29 when Dollarama released its 2017 fourth-quarter earnings results, which show no sign of growth slowing.

Another quarter that exceeds expectations

The dollar store chain profit climbed by 11% to $162.8 million in the fourth quarter. Diluted profit rose 17% from a year earlier to $1.45 per share, beating analysts' forecast of $1.40 per share.

This quarter is the 13th consecutive quarter during which Dollarama has delivered better-than-expected results, and expectations are still high for this leader in the retail sector.

Sales totaled $938.1 million in the fourth quarter, up 10% from 2016 last quarter, boosted by comparable-store sales growth of 5.5%. The average transaction jumped 4.6% due to the increased number of items over $3 and the use of credit cards.

The retailer increased its quarterly dividend by 9% to $0.12 per share and plans to split its shares on a three-for-one basis.

Dollarama will expand its distribution centre in Montreal to support the company's planned expansion to a maximum of 1,700 stores by 2027.

Last year, Dollarama has developed technological initiatives to improve store productivity, like handheld scanners for employees.

The company will start selling merchandise online this year to consumers wishing to buy certain items in bulk.

Bottom line

Dollarama's growth is expected to be 17.5% per year on average for the next five years, while the TSX is expected to grow by 11.7% per year on average over the same period. So, regarding growth, Dollarama is a better buy.

However, Dollarama is more expensive than the TSX, with a forward P/E of 26.1 for the former vs. 15.2 for the latter.

If you have a long investment horizon, Dollarama looks like a better buy for its higher-growth perspectives. Furthermore, with a beta of only 0.4, Dollarama should perform better than the TSX in a bear market.

But if you are investing for a short-term period and are not afraid of volatility, I think the drop in the TSX represents a buying opportunity.

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