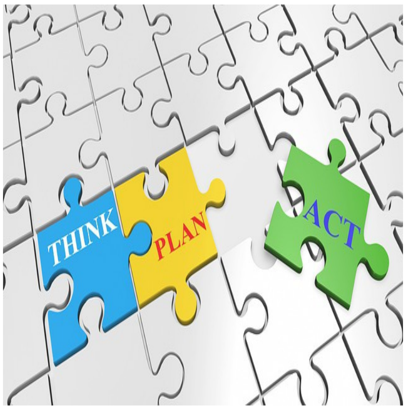

Discount vs. Convenience: Which Is the Better Buy?

Description

As far as Canadian retailers go, **Dollarama Inc.** (TSX:DOL) and **Alimentation Couche-Tard Inc.** (TSX:ATD.B) are two of the best retail stocks to buy on the TSX.

Both have been in growth mode the past few years; Dollarama is opening new stores, and Couche-Tard is acquiring them. As a result, both stocks have greatly appreciated with Dollarama delivering an annualized total return of 36% over the past five years compared to 25% for Couche-Tard.

Most investors would be happy with either stock's performance.

The next five years

At the very core, Dollarama's business is about low prices ($4 or less), while Couche-Tard's is about convenience. Clearly, consumers were attracted to both business models over the past five years. The question is whether they'll continue to feel this way in the future.

The global research advisory firm IHL Group published a study last August of 1,800 U.S. retail chains with 50 or more stores. It found that convenience stores and dollar stores were opening the most net new locations of any retail segment.

Furthermore, of the top 16 banners opening 4,162 stores between January and July 2017, six were either dollar stores or convenience stores, accounting for 69% of the new store openings over the first seven months of the year.

Banner	New Stores
Dollar General Corp. (NYSE:DG)	1,290

Dollar Tree, Inc. (NASDAQ:DLTR)	650
7-Eleven	412
Couche-Tard	318
Casey's General Stores Inc. (NASDAQ:CASY)	100
Five Below Inc. (NASDAQ:FIVE)	100

Source: IHL Group, Debunking the Retail Apocalypse, August 2017

Dollarama is not on the list because it's Canadian, but the reasons for this concentrated growth do carry over to Canada.

"We really see growth in stores mostly mirroring what is going on with the incomes of consumers, more discounters, less mid-range or luxury," wrote study authors Lee Holman and Greg Buzek. "With 50% of the households having trouble keeping up with inflation, this makes perfect sense."

Certainly, here in Canada, we've seen middle-market retail stores get hollowed out — Sears Canada being the latest example and possibly the most devastating to Canadian retail workers — and stores like Dollarama are benefiting from this phenomenon.

"Consumers are going to be hard-pressed to keep on spending," Willy Kruh, KPMG's global and Canada chair of Consumer and Retail said in December addressing the slowing economy, rising interest rates, and increased debt loads of Canadians. "As consumers feel the squeeze so will retailers — especially those who need to do more to optimize the shopping experience."

That's great news for Dollarama.

What about Couche-Tard?

If anyone is going to be able to be successful in the current retail transformation underway in North America, it's going to be Couche-Tard.

In 2017, the convenience store industry in the U.S. had its slowest annual merchandise sales growth since 2013. That's clearly evident, as Couche-Tard's U.S. same-store merchandise revenues through the first nine months of fiscal 2018 increased by just 0.5%.

It's this slowdown that prompted it to hire its first chief marketing officer to recharge Circle K sales in both the U.S. and Canada. Europe, however, appears to be firing on all cylinders with same-store merchandise revenues up 2.3% through Q3 2018 on significantly higher margins.

Diversification is one reason I believe Couche-Tard will rebound from its current North American sales slump that's hindered its stock price. It does a great job integrating acquisitions, including paying down the debt used to make the purchases; as it expands in Asia and Latin America and elsewhere, North America won't be nearly as important to its future.

Which is the better buy?

I like both stocks.

Retailing and economic indicators suggest Dollarama has the edge. However, Couche-Tard is an excellent operator and will continue to gobble up smaller convenience-store chains in the years ahead. It's also a better buy in terms of value trading at 12 times cash flow compared to 27 times cash flow for Dollarama.

It's close, but I'm going to go with Couche-Tard based on the value play.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:CASY (Casey's General Stores, Inc.)
2. NASDAQ:DLTR (Dollar Tree, Inc.)
3. NASDAQ:FIVE (Five Below, Inc.)
4. NYSE:DG (Dollar General Corporation)
5. TSX:DOL (Dollarama Inc.)

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Date
2025/07/03
Date Created

2018/04/14
Author
washworth