Is Dollarama Inc. (TSX:DOL) on its Way Down?

Description

After a strong 2017, in which **Dollarama Inc.** (TSX:DOL) soared in stock price, this year things have looked much different. Last year, the share price grew by 60%, but year to date it has declined 3%. Since hitting a peak price of $170 earlier this year, the stock has struggled to even get to $160. Depending on how you look at it, it could be a good time to buy it at a depressed share price, or it could be the start of an even bigger decline for Dollarama.

What prompted the drop in price?

It was days after the company announced that it would be issuing $300 million in unsecured notes that we saw the share price start to crash, as investors may have started worrying about Dollarama's rising debt levels. With debt of nearly $1.3 billion, the company's debt levels have more than tripled in just four years, and in its most recent quarter they were up 20% year over year.

While Dollarama is expanding and continuing to increase the number of stores that it is operating, that's not what's using up a lot of the company's cash. In fact, Dollarama has produced strong free cash flow in each of the past five years, and in the trailing 12 months it has accumulated more than $500 million. The problem is that the company has been very aggressive in the repurchase of its common shares.

Over the trailing 12 months, Dollarama has repurchased $812 million in shares, which is far in excess of the company's free cash and is a pattern we've seen the company do over the years, as debt levels have climbed. This is a questionable use of cash that could be put to better use. Repurchasing shares will inflate metrics like earnings per share and give the stock price an artificial boost.

The company would have been better off bringing its debt down rather than adding to it, so it could buy back shares. The stock is an expensive buy, and it's not a good deal for investors. The company has negative equity, and even after all the repurchases it still trades at 33 times its earnings.

Another odd choice of cash is Dollarama's quarterly dividend payments, which, at $0.48 per year, amount to a yield of just 0.3%. While the company may be looking to build a dividend-paying history by starting slow, investors likely would have preferred that money go to paying down some of the company's debt. And at such a small yield, it's not going to attract serious dividend investors, which makes me question what it is going to accomplish in the end.

Bottom line

The hype has clearly started to fade from Dollarama's stock, as it has simply not seen the same level of excitement as it did a year ago. With half of 2018 nearly gone, the share price has not seen much momentum, and we could see more of a correction on the way. While the level of growth that the company has achieved is exciting, I'm not a fan of some of the decisions the company has made and would be wary of investing in the stock today.

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