Could the Upcoming Stock Split Be the Catalyst Dollarama Inc. (TSX:DOL) Needs?

Description

Lost amid the sea of negativity surrounding **Dollarama Inc.** (TSX:DOL) is its upcoming stock split. In late March, the company proposed a three-for-one stock split. Investors will receive two additional shares for every share of Dollarama they own.

Scheduled to take place June 14, the stock split is just around the corner.

Will it be the catalyst the company needs to break its current downtrend? It's unlikely.

After Dollarama's announcement, I dug a little deeper to see what impact, if any, stock splits have on a company's stock price. The result? It has little impact. The results are not surprising, as splits don't change a company's fundamentals.

There have only been three large-cap TSX companies to announce a stock split between 2015 and 2017. All underperformed the market the year following the split — not what I would call a positive catalyst.

What does this mean for Dollarama?

The company is scheduled to release first-quarter earnings next week. It will no doubt spin its upcoming share split as positive for the company.

President and CEO Neil Rossy attempted to do so during its fourth quarter conference call.

> *"A share split can improve liquidity and make our shares more accessible to a broader range of investors, especially retail investors."*

Sounds great, right? Don't buy into the rhetoric. It should be viewed as a non-event.

Solid fundamentals aren't enough

Dollarama has been the dominant Canadian player in the discount retail space; its growth has been nothing short of spectacular.

The company is very profitable and has been expanding gross margins. Over the past five years, Dollarama has grown net income by a compound annual growth rate (CAGR) of 18% with a growing dividend.

So why is the company's share price stagnating? The problem is three-fold.

Increased competition

Fool contributor Joey Frenette did a good job of detailing the first issue: increased competition. I'll add a bit more colour to its biggest threat to date: Chinese discount retailer Miniso.

On Wednesday, Miniso announced its aggressive plans for Canadian expansion. Within three years, the company plans to open 500 new stores across the country. Let that sink in for a minute.

In the next three years, Dollarama will be faced with new competition in approximately 50% of its markets. Dollarama executives claim that Miniso is not a direct competitor. Thus, they intend to treat the retailer as they would any other indirect competitor.

This line of thinking may prove costly, and Miniso should be taken seriously.

High valuations, slowing growth

Trading at 33 times earnings, Dollarama is expensive. Likewise, after years of rapid expansion, its growth is slowing. These are the final two factors weighing on its share price.

The company is expected to grow earnings by 18% in 2018 and 15% in 2019. That's not bad, but it's not enough to justify a forward price of 25 times earnings.

Dollarama is facing plenty of headwinds with no catalyst. It's a good company, but it's just not attractive at these valuations amid increased competition.

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