Should You Buy Dollarama Inc. (TSX:DOL) Ahead of Earnings?

Description

Dollarama Inc. (TSX:DOL) is expected to release its quarterly earnings later this week, and investors may be wondering whether it's a good time to buy the stock. Dollarama has done well over the past four earnings results, but its stock price hasn't always taken off. And while the company had a strong 2017, year-to-date the stock has declined 2% as signs suggest that the share price peaked when it hit $170 earlier this year and its new home might be closer to $150.

Dollarama has been continuing to grow at a time when many retailers have struggled or simply gone out of business. Despite the company's success, rising minimum wages are likely weighing on investors amid concerns that Dollarama and other retailers won't be able to remain competitive alongside an online giant like **Amazon.com, Inc.** (NASDAQ:AMZN) that doesn't have to deal with the headaches that come with running a conventional storefront.

The one benefit for Dollarama, however, is that its low-cost model and inventory wouldn't make sense for a typical consumer to purchase online, especially since shipping costs would negate any benefit of obtaining any savings on a one or two dollar item, unless buying in bulk.

Let's take a look at both sides of the equation and assess whether Dollarama is a good buy ahead of its upcoming earnings.

Why the stock is a buy

The growth that Dollarama has achieved has been incredible given the circumstances in the industry. Since 2014, sales have grown by nearly 60%, and in the company's most recent quarter, revenues were up 10% from a year ago. Profits have seen even stronger growth, with Dollarama's bottom line doubling over the past four years. In the past five quarters, the company has averaged a very strong 16% profit margin.

With so much growth, it's easy to see why many investors are bullish on Dollarama's stock. And with interest rates rising, consumers will see housing costs increase, making it all the more important to save as much as possible. Dollar stores offer an easy way for consumers to cut costs.

Why the stock isn't a good buy

On the bearish side, investors will notice the company's wasteful repurchase of shares as being an inefficient use of resources considering the expensive price of the stock right now. Dollarama would be better off using the money to invest into its operations or perhaps paying more of a dividend to its shareholders.

Rising interest rates will have both a bullish and bearish impact on Dollarama. Although more discount seekers will come into the company's stores, Dollarama will be paying more in interest costs, as its debt has tripled since 2014. Interest costs reached $40 million last year, which is double what the company incurred just a few years ago.

Bottom line

Investors are paying a big premium for the stock, and given the challenges that it faces, it's not a bet I'd make today. Investors have been lukewarm about the stock since it hit $170 this year, and unless Dollarama has an incredible earnings performance, you shouldn't expect to see much of a bump in the stock's price on earnings day.

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