Could Dollarama Inc. (TSX:DOL) Pull Off a Five Below (NASDAQ:FIVE) Upward Spike?

Description

With fellow discount store chain **Five Below Inc.** (NASDAQ:FIVE) soaring a staggering ~42% so far this month after posting a blowout quarter, one couldn't help but to give our Canadian discount store chain **Dollarama Inc.** (TSX:DOL) a second look after shares pulled back ~12% from all-time highs. After all, Dollarama draws some comparisons to the smaller rapidly expanding American success story that is Five Below.

For one, they're both dollar stores that sell items at or below a certain price cap with Five Below and Dollarama requiring all shelved merchandise to be priced below $5 and $4, respectively. In other words, another name for Dollarama could be Four Below!

Although it may just seem like a $1 difference between stores, it's important to remember that the U.S. dollar is much stronger at these levels, so a Canadian equivalent of Five Below would actually be closer to a Seven Below! As you'd imagine, there are much cooler items you could get for $7 than for $4.

What's been Five Below's secret to its recent success?

Unlike Five Below, Dollarama is more of a generic discount retailer, selling everything from party supplies to low-cost consumer packaged goods. A major reason for Five Below's success is the fact that it's differentiated itself from the generic dollar store crowd by catering to younger audiences like teens, pre-teens, and children.

In catering to a younger audience, Five Below sells a tonne of toys, and because of the slightly higher price cap versus many other dollar stores, the company has been able to offer a wider range of "premium" trendy items without compromising on the store's promise of keeping the price of all items below the $5 price cap.

If you have the opportunity to walk into a Five Below store, you'll find out pretty quickly that there are some pretty cool toys (and games, candy, etc.) that you can buy for under $5. And at first glance, you wouldn't have guessed that such items would be priced at or below $5! The quality just isn't indicative of a low-cost item.

Could Dollarama fly through the roof like a coiled spring in the same way Five Below did?

Five Below has seen its top and bottom lines really skyrocket, as its gross margins continue to expand. The result? A sudden pop in shares like a coiled spring. Although Dollarama isn't slated to experience the same magnitude of earnings growth (net income surging 160% for a quarter) in the foreseeable future, let's not discount the fact that Dollarama has been one of the premier growth stocks over the past five years, when shares have more than quadrupled up.

There's no question that Five Below is in a realm of its own and is not really comparable to a generic dollar store like Dollarama, which caters to bargain-hunting consumers of all ages.

Moreover, Dollarama's decor isn't exactly what you'd describe as pretty when compared side by side to Five Below's decor. It's not just the quality of the goods being sold at Five Below, but the way in which they're presented that has drawn consumers through the door in stampedes.

With Dollarama, you've got a tonne of top-notch items priced at bargain-basement prices, but with cardboard boxes stacked on the floor, shopping carts tightly packed at the entrance, and no "featured goods" at the viewing window other than a column of cheap sunglasses, I think the company's not doing itself any favours on the comps growth front.

In addition, a lower loonie may serve to hurt margins over the near term. To alleviate the pressure, Dollarama may want to consider upping its price cap like it has in the past. Who knows? Maybe Dollarama can command a $6 price cap and offer higher-quality discount goods like Five Below has.

With this in mind, those looking for Dollarama to pull a Five Below ought to look elsewhere because a coiled spring stock pop just isn't in the cards for now, especially after witnessing weak sales in Dollarama's most recent Q1 fiscal 2019 report.

After the recent dip though, Dollarama is still a solid long-term holding. Just don't expect much more than an average return over the next year.

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Date
2025/08/28
Date Created
2018/06/15
Author
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