Can Dollarama Inc. (TSX:DOL) Turn It Around?

Description

It's been a rough year for Dollarama Inc. (TSX:DOL) stock. Starting off the year at $51.67 (adjusted for a stock split), it has since slid to $48.80. That's a 5.5% decline–certainly not the biggest TSX loser of the year, but pretty weak performance nonetheless. At the same time, the underlying company is doing well, with modest earnings growth and strong profitability metrics.

What's going on here? Is Dollarama overvalued? Is the company underperforming in some hard-to-quantify way? Or is the market simply wrong, making today a great time to buy Dollarama stock?

It helps to start by looking at valuation.

Valuation

Dollarama currently trades at about 31 times earnings. That's a fairly high P/E ratio, but nothing outside the realm of sanity. And yes, the company is growing, both in terms of revenue and net income. However, earnings growth was modest at 7.3% year-over-year in the most recent quarter.

With a relatively high P/E ratio and earnings growth typical of a mature company, it's possible that Dollarama is overvalued. This is a company that grew at rapid rates in past years, with five-year average earnings growth of around 25%. In the past, the market rewarded it with premium prices typical of growth stocks. With growth having slowed, investors may be losing enthusiasm and selling their shares.

But could Dollarama's growth pick up steam again?

To answer that question, we need to look at the company's market position.

Market share

According to Statista, Dollarama had an 18% market share in Canadian discount retail in 2016. Its closest competitor, Dollar Tree, held 2.2%. Since Dollarama's growth has slowed since 2016, I inferthat its market share is probably still around the 18-20% range.

This might indicate that Dollarama has room to grow. Not necessarily, however. "Discount retail" is a broad category that includes more than just Dollar Stores. Wholesalers and companies like **Walmart** are also part of it. Dollarama cannot reasonably expand into these niches without a drastic change of approach–something management has not indicated is on the table. So it's actually possible that Dollarama has already saturated the Canadian dollar store market.

Global expansion?

That leaves us with the possibility of expanding abroad. As it's dominated by Dollar Tree, the U.S. market probably won't be great expansion territory for Dollarama. But if the company sets its sights even farther away from home, there may be more potential.

Five years ago, Dollarama struck a partnership deal with the Central American company Dollar City. The deal included provisions for Dollarama to supply Dollar City with products and advise it on product management. Since the deal was struck, Dollar City has expanded from 15 locations in El Salvador and Guatemala to 77 (plus nine in Colombia). This expansion mirrors Dollarama's own early expansion.

With lucrative supply contracts, Dollarama could ride the coattails of Dollar City's expansion should it continue. However, that's a big "if." So far the Dollar City deal hasn't stopped Dollarama's steep decline in earnings growth. Absent a big earnings surprise in the future, this stock is probably overvalued.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:WMT (Wal-Mart Stores Inc.)
2. TSX:DOL (Dollarama Inc.)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Investing

Date
2025/08/17
Date Created
2018/09/06
Author

andrewbutton