Dollarama's (TSX:DOL) Stock Appeal Is Fading

Description

Canada's largest discount retailer hasn't had much to cheer about lately. Year to date, **Dollarama's** (TSX:DOL) stock has been flat, eking out a 0.78% gain. This is a far cry from the historical double-digit growth investors have come to expect from the company. Typically, stocks are grouped into one of three buckets: growth, income, and value. As of late, Dollarama hasn't fit any of these descriptions. As such, its appeal is fading.

On Thursday, Dollarama reported second-quarter results. Will it be enough to move the needle?

Missed estimates

Analysts were expecting earnings per share of $0.44 and revenues of $887.8 million. The company posted a miss on both the top and bottom lines. Diluted EPS came in at $0.43, while the company posted $868.5 million in sales. This represents bottom-line growth of 13.2% and top-line growth of 6.9% over the second quarter of 2017. Dollarama's increase in comparable same-store sales of 2.6% also missed estimates for 5.26% growth.

Gross margins remained flat, while earnings before interest, taxes, depreciation, and amortization (EBITDA) rose 30 basis points to 26% of sales.

The best news of the day was Dollarama's increased guidance. The company revised its gross margin target to 39% at the mid-range, up 100 basis points. Likewise, EBITDA as a percentage of sales is expected to reach 24.25% at the mid-range of guidance, up from 23.25%. Expenses were also revised downwards, 100 basis points below previous expectations. There was no change in the number of store openings or capital expenditures.

The revisions should lead to improved profitability in the second half.

Challenges remain

Total transactions dropped 0.5% over the previous year. The reduction was in large part due to last year's strong sales in relation to Canada's 150th anniversary. The drop in traffic was offset by the recapture of the weather-related shortfall in summer seasonal product sales experienced last quarter.

Dollarama opened eight new stores in the quarter. In comparison, the company opened 17 in the second quarter of fiscal 2018. Although consistent with management's guidance, this is further evidence that the company's growth is slowing.

The company is also facing increased competition. Chinese retailer Miniso is expected to make a big move in the country with the opening of 300 stores nationwide over the next three years. This is on top of dealing with U.S.-based **Dollar Tree's** Canadian expansion.

Revised valuation

Dollarama is currently priced as a high-growth stock. The company, however, isn't the same beast it was a few years ago. Growth is slowing, competition is about to increase, and the market is beginning to saturate. This is the main reason why the company's stock price has remained flat.

Including Thursday's Q2 results, the company is trading at 32.5 times earnings. Analysts expect the company to post earnings growth of 13% over the next few years before dropping to single digits. The company has a high P/E-to-growth (PEG) ratio of 2.5, which signifies that its share price has gotten ahead of its growth rate. As such, it is considered overvalued.

Dollarama is a great company, but it hasn't done anything this year to justify current valuations. Investors looking for high-growth or income stocks are best to look elsewhere.

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