Is Dollarama Inc’s (TSX:DOL) Disappointing Q2 a Sign the Stock Has Peaked?

Description

Dollarama (TSX:DOL) released its second-quarter results on Thursday, and while it continued to grow sales, it just wasn’t as impressive as it was in prior periods. During the quarter, Dollarama’s sales had grown by more than 6.9%, while profits were up by 7.6%. However, let’s take a closer look at these numbers and put the results into perspective with how the company did a year ago.

Sales growth starting to slow down

While Dollarama did have a good quarter, there are clear signs that things are starting to slow down for the dollar store chain, as a year ago the company’s growth was 11.5%. Same-store growth, which is typically an even better indicator of growth, since it factors out the growth achieved by simply opening more stores, was only 2.6% this past quarter compared to 6.1% last year.

These are some concerning numbers; they suggest that Dollarama may finally be coming down to mortal levels. However, these are still decent growth numbers that many retailers would be more than happy with these days.

If this becomes the new normal for Dollarama, then it will likely have an impact on the stock, which, last year, had a tremendous performance thanks to its impressive growth numbers. This year it has been a different story, as the stock has not been able to build on any positive momentum.

It wasn’t all bad news for Dollarama in Q2

Sales growth is a big factor for many investors, but it’s not the only one to consider. Profitability is very important, and Dollarama did make some progress on not only bumping up its gross margin, but in reducing its sales, general, and administrative costs as a percentage of sales. The net result was an operating margin that came in at 23.8% vs. 23.6% a year ago.

And while the company did see its total debt level rise, its cash on hand was more than triple its stockpile from a year ago, and so net debt was down slightly.

What does this mean for investors?

Dollarama has been trading at a premium, as investors have valued the growth the company was able to achieve very highly, particularly at a time when other retailers were struggling. But now with Dollarama no longer having an edge on growth and with it opening fewer stores than it did last year, that advantage seems to have disappeared, and so it’s no surprise that on Thursday the stock was down more than 17%.

Longer term, there are concerns about how much minimum wage hikes, tariffs, and NAFTA-related issues could impact Dollarama's competitiveness and profitability. If those factors force the company to raise prices, it could be enough for consumers to switch over to online retailers, particularly as shipping becomes quicker and more cost effective.

I've been skeptical about Dollarama's long-term growth for a while, simply because their numbers were a bit higher than what I believed was sustainable, and so I'm not surprised that there's been a slowdown, although investors may have been expecting a more gradual decline.

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