Is Dollarama Inc. (TSX:DOL) a Buy-Low Candidate After its Post-Earnings Drop?

Description

Dollarama (TSX:DOL) stock has plunged 15% over the past week as of close on September 17. Shares have now dropped 18.6% in 2018 so far. This drop was sparked by a disappointing second-quarter report that was released on September 13. Was the decline warranted? More importantly, is Dollarama a buy-low opportunity?

Q2 earnings fail to impress

In the second quarter of fiscal 2019, sales rose 6.9% year over year to $868.5 million, while comparable store sales grew 2.6%. This was compared to 6.1% growth in this area in the prior year. Diluted net earnings per share climbed 13.2% from the prior year to $0.43. The slip in expected sales and earnings caused management to revise its outlook for the full year in fiscal 2019.

According to the second-quarter report, the reduced rate in comparable store sales growth in the quarter was reflective of management's decision to minimize price increases. Dollarama leadership was adamant about moving forward with this policy, even after minimum wage increases in Ontario. Results also took a hit due to lower Canada Day sales compared to Q2 fiscal 2018, when sales were driven by higher volumes from Canada's 150 celebration.

As for its guidance, Dollarama still projects 60-70 new stores openings in fiscal 2019. Capital expenditures are also forecast to remain in the $190-200 million range. It now projects gross margin between 38.5% to 39.5% and EBITDA margin of 23.5-25%. Comparable store sales were revised down to the 2.5-3.5% range compared to the initial range of 4-5%. There are several factors that could impact this forecast going forward, so investors should keep this in mind.

The board of directors approved a quarterly cash dividend of $0.04 per share. This represents a 0.35% dividend yield.

Should you buy the dip?

In recent articles, I've discussed why Dollarama was one of my top picks for investors to hold as market conditions grow choppy. Dollarama stock has performed extremely well over the past decade. Shares are up over 1,200% since its initial public offering back in October 2009. Its rise is not just reflective of the company's success, but of dollar stores retail chains more broadly. Many retail chains have struggled in a challenging environment throughout the decade, while dollar stores have experienced historical growth.

Could this be changing as we head into the 2020s? It is likely that dollar stores will see growth slow in the coming years in comparison to the previous decade, but the long-term picture is still very positive. Investors are used to dollar store chains posting huge sales increases in prior years, but it may be time to temper expectations, especially as we enter the later period of the current economic cycle.

For these reasons, I have Dollarama as a solid pick up following its post-earnings drop. Its long-term growth trajectory is promising and dollar stores should still present attractive cover in the event of economic turbulence.

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