Down 28% YTD: Should Dollarama Inc. (TSX:DOL) Keep Buying its Stock?

Description

My views about **Dollarama** (TSX:DOL) seem to change by the day.

Although I'm generally a believer in the company's business model and its stock, I do think that the good times it's experienced in recent years are slowly becoming a thing of the past.

That's not to say I think you shouldn't own Dollarama stock. Quite the contrary. With the company's shares down 28% year to date, I'm wondering if CEO Larry Rossy shouldn't be cranking up the buyback machine.

The case against buybacks

A little over 17 months ago, I'd wondered whether it was a good idea for the company to be spending $602.2 million throughout the year to repurchase its shares. It wasn't that I was against buybacks, just that Dollarama was paying top dollar for those shares at a time when it had a significant amount of debt.

In fiscal 2017, Dollarama paid $33.59 a share to repurchase approximately six million of its shares for a total capital outlay of $602 million. That's adjusted for the July 2018 three-for-one stock split.

Based on the June 9, 2017, share price of $41.69 (post-split), Dollarama had achieved a return of 28% on its share repurchases up to that point. Unfortunately, since then, its share price has dropped another 11%, reducing its return to less than 11% over 17 months, a much less attractive return on investment for the company.

At the same time, its long-term debt has increased from $1.26 billion at the end of January to $1.37 billion at the end of July.

On a positive note, Dollarama repurchased just $70 million of its stock in the first six months of 2018, paying an average share price of $51.93 — 39% more than its current share price. In the same six months a year earlier, it repurchased $341 million at an average price paid of $37.87 a share for a zero return.

The case for buybacks

Buy low, sell high. It's the oldest rule in the book.

With short sellers like Spruce Point Capital pushing Dollarama stock lower, now might be the best time to be buying back its stock, which hasn't traded this low in 17 months.

"Ultimately, nothing has significantly changed about Dollarama's business model," wrote the Fool's David Jagielski November 3. "While the company is coming off a disappointing quarter where questions about growth came up, there's no guarantee that the store is now destined to keep missing its numbers."

I couldn't agree more.

Spruce Point Capital's logic for shorting Dollarama stock is that it's no longer a growth story, and because of that it could fall by as much as 40%. In Canada, that's somewhat true, but down in South America, it's got an opportunity to grow Dollar City, and there's no mention of that in its arguments against the stock.

Should Dollarama keep buying its stock?

Despite its level of debt, you buy back stock when it's trading below its intrinsic value. I believe it is. That said, I wouldn't want to see it pay any more than $40 a share until it gets its debt under control and less than $1 billion.

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