Has Dollarama Inc. (TSX:DOL) Become Too Cheap to Ignore?

Description

Dollarama (TSX:DOL) shares just keep stubbornly going down.

After years of seemingly being unable to do anything wrong, the company is still feeling the fallout from poor earnings numbers posted in September. Although the company posted nice growth metrics, investors headed for the exits when management disclosed slower same-store sales growth was to be expected going forward.

Shares promptly fell some 20% in one day, sparking bargain hunters and other value-oriented investors to consider the shares again.

But the company hasn't rebounded. In fact, shares have fallen even more. In total, the decline has been devastating, with Dollarama falling from $52 per share to just over $33 in only a few months. That's a total decline of more than 30%.

Is now the right time for value investors to take a closer look? Many think so. Here are three reasons why you should be considering Dollarama shares today.

Still offering terrific growth

Despite all the bad news, Dollarama is still a nice growth stock with loads of potential.

Over the long term, analysts believe the company can still increase its store count by 50% here in Canada, and it has potential to expand in certain international markets. It has only announced a tepid plan to introduce online sales to its portfolio, which means there's still growth potential there. And the company should be able to further goose the top line by adding higher-priced items or having a better product mix.

Oh, how quickly the market forgets about Dollarama's previous growth. Over the last five years, the company has increased revenue from $1.8 billion to more than $3.2 billion. Earnings increased from $221 million to $539 million. Free cash flow went from $0.33 to $1.36 per share during that same period.

Sure, growth might slow from these levels, but it's unlikely Dollarama is done with its expansion plans.

Shareholder-friendly management

Some investors might lament Dollarama's anemic dividend — the yield is well under 1% — but a look under the hood reveals a much different story. Instead of giving back to shareholders via dividends, Dollarama's management chooses to do so via share buybacks.

At the end of 2012, Dollarama had 451 million shares outstanding. After years of aggressive share buybacks, that number is down to 327 million shares as of the company's latest quarter. That's a reduction of 124 million shares, or 27% of total shares outstanding.

One argument against Dollarama's management might be that these shares were largely purchased at prices above today's levels. Perhaps in hindsight management would have liked to have waited for a lower price, but the commitment of steady share buybacks is far more important than the price paid.

Valuation

Dollarama shares haven't been this cheap in years.

Over the last year, Dollarama earned $1.62 per share. Shares currently trade hands at $33.60. That puts shares at just a hair over 20 times earnings. For much of the last decade, shares traded at between 25 and 35 times earnings.

Shares appear even cheaper on a forward earnings basis. Analysts expect Dollarama to earn $1.89 per share in its next fiscal year, putting the stock at just 17.7 times forward earnings. That puts Dollarama at about the same valuation as the TSX Composite Index as a whole, despite having far greater growth potential.

The bottom line

Value investors should be paying attention to Dollarama today. The stock is down significantly from all-time highs. It consistently posts profit margins better than competitors and its smaller store size means it can pick and choose the best-performing items. The stock's valuation hasn't been this low in years — if ever — and the stock could bounce back significantly if the stock's next quarter beats expectations.

Today is a rare opportunity to pick up a fantastic growth stock at a value price. These chances don't come along very often.

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nelsonpsmith