Why Is Dollarama Inc (TSX:DOL) Stock Down This Year?

Description

Dollarama (TSX:DOL) has had a rough year in 2018. Down 38% year to date, it's getting close to shedding half its value. Although the entire TSX has been getting hit this year, Dollarama is down much more than the TSX average, which has lost just 10% of its value in the same period.

This raises the question: why?

Dollarama is one of the most ubiquitous stores in Canada and has seen meteoric growth over the past decade. Starting from humble origins in Mount Royal, Quebec, the company has grown to more than 1,095 locations nationwide. That's the kind of growth you'd expect to see reflected in the share price, but it just isn't happening this year.

So, is this once fast-growing company's run at an end, or are its current doldrums a passing phase? To answer that question, we need to look at Dollarama's earnings growth.

Slowing growth

Dollarama's earnings growth has been stalling in recent quarters. In Q3 fiscal 2019, sales grew by 6.6% while earnings per share grew by 7.9% year over year. This is not exactly sluggish growth, but it's way down from Dollarama's heyday, when it was growing by double digits every quarter. For example, in Q3 fiscal 2014, diluted net earnings per common share were up 27% from the same quarter a year before. So, overall growth is way down. Same-store sales growth seems to be slowing as well: in Q3 2014 it was up 5.9%, while in Q3 2019 it was up just 3.1%.

Market saturation

One issue facing Dollarama is the possibility that it has saturated the Canadian market. Although analysts estimate that the company has the potential to open 500-1,000 more stores in Canada, it is not currently opening stores at a rate that would ever get it there. The chain already has multiple locations in every major Canadian city and 10 times the market share of its closest competitor **Dollar Tree**. Dollarama could theoretically grow by expanding internationally, but its efforts in this arena have been spotty, to say the least.

International expansion stalling

Broadly speaking, Dollarama has not fared well with international expansion. Although the company did sign a supplier agreement with the Latin American chain Dollar City, it's been five years since that deal was struck and not much has come of it. One thing worth noting about the Dollar City deal is that it gives Dollarama an option to acquire 50% of that company, which in turn paves the way for a complete buyout. That certainly is one way for Dollarama to acquire an international presence, but the fact that management hasn't pulled the trigger on it in five years suggests that perhaps it's not a great investment.

A final option for Dollarama would be to expand into the United States, but I'm not optimistic about that. The U.S. Dollar Store market is hyper competitive and well-served by Dollar Tree and other massive companies. Although the weak Canadian dollar could give Dollarama an "in" to the U.S., the lower overall cost of consumer goods in the States works against it. Although I've recommended Dollarama as a recession-proof pick in the past, it's definitely not a good choice for the growth-hungry investor.

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