Dollarama Inc. (TSX:DOL) Compares Favourably to Its U.S. Counterparts

Description

In my last article about **Dollarama** (TSX:DOL), I suggested that despite its level of debt, the company would be smart to repurchase its shares anywhere below $40.

That was November 9. Since then, DOL stock has lost another 15%, dropping into the low $30s, its worst level since June 2016.

The Dollarama bloom has indeed gone off the rose.

Before investors give up on the discount retailer, one might consider Dollarama in context to its U.S. peers such as **Dollar Tree** and **Dollar General**. If there's a case to be made that Dollarama's the best of the trio — based on valuation, growth potential, management team, business model, etc. — it should be made.

Dollarama's prospects in 2019

Heading into 2019, Dollarama expects to finish the fourth quarter having opened between 60-70 net new stores, a gross margin for the year of at least 38.5%, same-store sales growth of 2.5%-3.5% for the fiscal year, and an EBITDA margin of at least 23.5%.

On the Dollar City front, its South American partnership continues to hum right along, growing by 43 stores in 2018 through the end of September, to 150 locations with 61 in Colombia, 42 in El Salvador, and 47 in Guatemala.

As part of its agreement with Dollar City's owners, Dollarama has the option of buying 50.1% of the South American discounter starting in 2020, something Fool contributor Nelson Smith recently alluded to.

"Growth potential in Central and South America is massive, and Dollar City is doing the right thing by expanding into markets with higher per capita incomes," Smith wrote December 16. "There are approximately 100 million people in Colombia, Peru, and Ecuador. It's a prize that could easily one day rival Canadian operations."

You better believe it. I've long held that the option to buy control of Dollar City is virtually ignored by North American investors who are not up to speed on the potential of Latin America.

Do Dollar Tree or Dollar General have this type of opportunity available to them? Not that I know of.

The prospects of its peers

Dollar Tree's business has a good part and a bad one. The Dollar Tree banner is doing just fine. In Q3 2018, it had same-store sales growth of 2.3%. However, its Family Dollar chain, which it paid $9.1 billion for in July 2015, had a same-store sales contraction of 0.4% in the quarter.

As a result, the same-store sales overall increased by just 1% in the quarter compared to 3.1% for Dollarama. Up 1.4% through the first nine months of the year, it's unlikely that Dollar Tree is going to be able to match Dollarama's same-store sales growth for the year.

Onto Dollar General.

It fared much better in the third quarter, with same-store sales growth of 2.8%. Through the first nine months of the year, it had same-store sales growth of 2.9%, 20 basis points higher than Dollarama. However, in fiscal 2018, Dollar General expects same-store sales growth to be no more than 2.8%, less than the high-end of Dollarama's outlook of 3.5% growth for the year.

And of course, neither of these discounters have a South American connection.

It all comes down to valuation

Based on the potential of South America combined with the fact Dollarama's same-store sales growth is higher than both of its peers, suggests that it still deserves a slightly higher multiple than either Dollar Tree or Dollar General.

According to Morningstar, Dollarama's got a forward P/E of 14.6. That compares to 14.7 for Dollar Tree and 15.7 for Dollar General. On that basis, Dollarama appears undervalued.

Metrics like price-to-sales, however, suggest it's not nearly as undervalued compared to its peers, as one might think.

At the end of the day, I believe that its option to buy majority control of Dollar City tips the scale in its favour. In 2019, I expect institutional buyers will look upon Dollarama more favourably than its U.S. peers.

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