Is Dollarama Stock a “Screaming Buy” at $35 a Share? Maybe Not

Description

I’ve had my eye on the stock of **Dollarama Inc** (TSX:DOL) for quite awhile in search of an attractive entry point in the company’s shares.

I’ve long admired the success that the company has enjoyed in expanding throughout the Canadian market and in establishing itself as the country’s leading discount, or “bargain bin” retailer.

But while it may be about to start facing new competition from the formerly-defunct Bi-Way, whose owners recently announced plans to re-enter the Canadian discount retail market, that actually isn’t my biggest concern at this point.

What’s kept me from pulling the trigger on an investment in the DOL shares is in fact a different story altogether.

I seem to be losing faith in just how much “gas” is left in the tank in terms Dollarama’s growth trajectory; others may disagree, however.

Mind you, that seemingly endless trajectory of growth has for the most part been the narrative driving the firm’s share price to all-time highs in recent years.

Which only means that if there are indeed signs that perhaps the wheels are beginning to come off the wagon, I may need to continue holding off on a purchase in Dollarama stock for at least a little while longer.

Part of the issue I’m having is the risk that perhaps some of the headline numbers being reported are threatening to overshadow what appears to be a slowdown in the health of the company’s underlying retail business.

In the third quarter of the company’s fiscal 2019, which was reported on December 6, Dollarama reported diluted quarterly earnings per share growth of 7.9% which actually sounds pretty solid.

But in that release, it also reported same-store-sales growth of 3.1% in the quarter – which isn’t exactly bad either – but was lower than the 4.6% same-store-sales growth it had reported a year earlier.

Digging a little deeper into the report, however, reveals a potentially more troubling picture.

While same-store-sales were up 3.1% in the third quarter, most of that growth was attributable to a 4% increase in average transaction size, while the number of customers making trips to its stores actually decreased by 0.9%.

But I guess the biggest question I have at this point is how the company's planned response to the slowdown in traffic volumes could affect its long-term business strategy.

The company says that response will be at a minimum to slow the pace of price increases at its stores while turning its focus to highlighting the very cheapest inventory that it has available for sale, specifically those items on the shelves selling for under $1.25.

Maybe that will be enough to bring more foot traffic into its stores, and it will at least alter its brand positioning in minds of those are regular shoppers at Dollarama.

But what if it the strategy isn't successful in reinvigorating foot traffic?

Absent of the type of price increases that have been so instrumental in fueling the company's top-line growth in recent years, if increases in traffic volumes fail to materialize, shareholders may end up wishing they had exited the shares back when they traded above $50 over a year ago.

In light of the success this firm – and its shareholders – have enjoyed over the past decade, one has to wonder if this isn't a company that with a valuation already stretched thin and on the verge of a margin compression scenario which, if it were to play out that way, could lead to potentially disastrous outcomes for the company's investors.

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