Investors: Sliding Retail Sales Mean Caution Is Warranted for Retail Stocks Such As Dollarama Inc. (TSX:DOL)

Description

Canadian retail sales fell again in February for the third consecutive month of declining sales.

And while this decline of 0.3% isn't big, it's nonetheless a significant sign of the times – – times that are seeing slower growth in Canada as the consumer is burdened with high debt levels and pretty much seems to be tapped out amidst falling housing prices and economic uncertainty not only at home, but globally as well.

I would be wary of retail stocks in general at this point in favour of consumer staples retailers.

The following two stocks certainly have their merits, but I single them out here because of their recent stock price weakness and their size.

Dollarama Inc. (TSX:DOL)

Dollarama's earnings growth has settled in at about 11% these days compared to an earnings growth rate in the low to mid 20% range a few years ago.

As the company has grown, growth rates have slowed, partly because it is now off of a higher base, but also because lower traffic, rising operating costs, and because an end to price increases has taken a toll on the company and the stock.

Earnings have come in slightly below expectations in the last two quarters, and earnings estimates have been revised slightly downward.
At one point, this investor darling was trading at lofty multiples (almost 30 times) and trending higher and higher with seemingly no thought to the cyclical nature of retail stocks.

The mere hint of cracks in the company's business was enough to send Dollarama stock plummeting 44% from its 2018 highs. And although the stock has since recovered a bit, it is still down over 32% from those highs.

So estimates for Dollarama have been slowly coming down, and while the stock is certainly trading at much more attractive multiples at this point since the stock price has come down so much, with a softening retail sales environment, what are the catalysts for the stock?

The stock still trades at a P/E multiple of 21 times this year's expected earnings, down from when it was trading at 29 times, but still not cheap considering that same-store sales numbers are slowing.

Canadian Tire Corporation (TSX:CTC.A) is, in my view, a safer bet.

Canadian Tire offers a healthy and growing dividend of $4.15 per share and a dividend yield of 2.91%, and with one of the most recognizable brand names, a long history and $13.5 billion in revenue, Canadian Tire has an unrivalled position in the Canadian retail industry.

It offers a diversification unmatched by Canadian retailers, and it trades at attractive valuations.

It will be less affected by a downturn in consumer spending, but it too, cannot escape this.

Final thoughts

In closing, I don't think this environment of declining retail sales and high consumer debt levels is the environment to be buying these retail stocks.

But I would certainly keep them on my radar for the future, as they both have strong competitive positioning in the Canadian retail market.

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2. TSX:DOL (Dollarama Inc.)

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