3 Things That Can Cause Dollarama Inc. (TSX:DOL) Stock to Surge

Description

Despite the huge drawdown of about 30% from mid-2018, no one can argue against the fact that **Dollarama** (TSX:DOL) has been an excellent long-term investment.

An investment in Dollarama stock from 2009 has delivered total returns of +29% per year — completely outperforming the North American markets by a wide margin. In the period, the U.S. market delivered total returns of +12% per year.

Dollarama's outperformance was largely attributable to its double-digit earnings growth that occurred almost every year. Of course, its growth has tapered off, which is why the growth stock has experienced some multiples contraction and the stock has fallen.

Do not worry. There's hope. Here are three things that can propel Dollarama stock higher.

Dollarama can hitch on international growth as soon as 2020

Dollarama entered into a licensing and services agreement with Dollar City in 2013 to help the value retailer expand its operations in Latin America. Essentially, Dollarama has been sharing its business expertise with Dollar City as well as supplying merchandises to the chain.

What's really exciting for Dollarama investors is that the agreement also provides Dollarama with the option of buying a majority stake in Dollar City in February 2020.

You see, Dollar City is growing at a rapid pace. In 2013, it only had 15 stores in El Salvador and Guatemala. Today, it already has more than 150 locations in El Salvador, Guatemala, and Colombia. Dollar City can be Dollarama's ticket to gain exposure to higher-growth markets in Latin America.

Introduce new price points

Dollarama began with selling merchandises at $1 or less. It has steadily raised its price point to up to $4, which is still very affordable. The value retailer can easily introduce higher price points. Even raising the price point to just $5 implies a huge percentage increase over $4.

Each time Dollarama introduces a new price point, it's able to offer a greater range of merchandise, which attracts more traffic. Ultimately, new price points and a wider selection of quality merchandise should boost sales and earnings.

Market's realization of Dollarama's strong cash flow generation

Although Dollarama's growth has tapered off, it still generates strong and growing cash flow. In the last reported nine months, it had more than $155 million of free cash flow after accounting for capital spending and dividends paid. If the growing cash flow continues, the stock can trade in the $40s range sooner than you think.

Investor takeaway

Dollarama's high debt levels can be a concern to some investors. Currently, it has a debt-to-cap ratio of about 88%. However, its recent interest coverage ratio of greater than 17 is very strong.

Coupled with strong cash flow generation and value offerings that should be even more popular in tough economic times, the correction in Dollarama stock seems like a great opportunity to start accumulating shares in the proven business.

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Date
2025/08/02
Date Created
2019/03/30
Author
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