China Just Became Dollarama's Best Friend

Description

It's not very often that a Canadian company gets an advantage over its American competitors, but that's exactly happened at the stroke of midnight on May 10.

The U.S. upped the tariff on some $200 billion of Chinese imports from 10% to 25%. It's possible the Trump administration could apply the 25% tariff to an additional $325 billion in Chinese imports, effectively taxing every Chinese product that's imported into the country.

That's a disaster if you're an American importer.

How does it affect Dollarama?

Dollarama (TSX:DOL) imports 55% of the goods that go on its shelves from China. Those imports enter the country without a tariff penalty unlike what its competitors' **Dollar Tree** and **Dollar General** face in the U.S.

However, it doesn't get off scot-free. Canada has import tariffs on American products in retaliation of the American's steel and aluminum tariffs. It also doesn't help that Canada is in the middle of a legal battle with China over the court proceedings to extradite Huawei Technologies CFO Meng Wanzhou to the U.S.

So, it's not as simple as saying the ratcheting up of the trade war between the U.S. and China is a win for Canadian companies such as Dollarama, but I think it's fair to say that CEO Neil Rossy would prefer to be in his position vis a vis China than in the U.S.

The tariffs could really hurt American importers of Chinese goods. And while most American companies will have made changes to their sourcing to work around the issue, dollar stores have less flexibility to raise prices.

Dollarama's competitors paying a big price

Dollar Tree estimates that a jump to 25% on the $200 billion in imports would cost the company $140 million annually. In its fourth-quarter earnings call, CEO Gary Philbin put on a brave face for analysts.

"As always we're going to manage in real time," Philbin said about managing for higher tariffs. "I look forward to the bottom line, where it gives us an opportunity to invest in the business as we see tariffs change from 25 to 10, or 10 to 0."

Well, the worst-case scenario Philbin was managing for is here. Good luck with that.

How much would Dollarama pay under the same scenario?

It has annual sales one-sixth Dollar Tree's, so a rough estimate would be $23 million annually. That doesn't seem like much, but it works out to $0.07 a share based on 328 million shares outstanding. Dollarama earned $1.67 a share in fiscal 2019, so it would be a 4% hit to the bottom line.

Given the same-store-sales headwinds Dollarama's experienced in recent quarters, a 4% hit to profits would be a much bigger deal.

If you own Dollarama stock, the fact that it's not in the direct line of fire ought to be very comforting to you.

The bottom line on Dollarama stock

I'm a glass-half-full kind of person.

I believe that Dollarama remains an excellent investment opportunity despite the fact it's already opened 1,200 stores in Canada. I also think that it compares favourably to its U.S. competitors, even more so with the increased tariffs, and that it will continue to be one of the best long-term investments available on the TSX.

Fellow Fool Nelson Smith recently argued that Dollarama is a relative bargain at 22.4 times its 2019 estimated earnings.

One of his major arguments for DOL stock is the company's growth opportunity in Latin America. It has an option to buy 50% of Dollar City in 2020, a dollar store with 150 locations in Honduras, Colombia, and El Salvador.

Smith is spot-on accurate.

North American investors continue to fail to appreciate the economic opportunities that exist in Central and South America. Forget Venezuela and focus on countries like Colombia that are killing it — just be thankful you don't own Dollar Tree or Dollar General stock right now.

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Date
2025/07/03
Date Created
2019/05/12
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