Is Dollarama (TSX:DOL) a Buy?

Description

After providing market-beating returns since the early 2010s, **Dollarama** (TSX:DOL) has slowed its ascension a bit over the past year and a half. Of course, this period roughly coincides with global economic uncertainty that translated to a difficult time for equity markets. Perhaps investors shouldn't read too much into it.

However, Dollarama is currently selling at 27 times past earnings, which far exceeds the average TSX/S&P Composite Index's P/E ratio. The firm's forward P/E of approximately 21 is also relatively high. Is Dollarama worth buying at these levels?

Revenue and earnings growth

Dollarama was able to build a strong competitive advantage by opening stores that are often located in convenient and strategic locations (such as large metropolitan areas) and offer a wide range of products for relatively cheap prices. By becoming the go-to store for items under a certain price tag, the Montreal-based company built a certain level of customer loyalty. Dollarama has also increased the number of stores it owns at a nearly exponential rate in the early to mid-2010s.

These factors led to strong growth in the company's top line. Between 2010 and 2018, Dollarama's revenues grew at a compound annual growth rate of about 12.8%. The company's net income fared even better, delivering a CAGR of almost 28% over the same period. This was due in part to an increase in efficiency. Dollarama's net profit margin grew from about 5% in 2010 to 15% in 2018, and the dollar store has also been turning over inventory at a faster pace.

Dollarama faces stiff competition

Many of the factors that made Dollarama so successful over the past decade are now being threatened. First, the rate at which the company is opening new stores has slowed. Second, the firm has faced increased competitions over the years. These competitors include both brick-and-mortar stores and e-commerce giants. As a result, Dollarama's comparable store sales growth has been decreasing.

Dollarama has gradually introduced higher-priced items to keep up with the competition. However, this strategy ran the risk of backfiring, since Dollarama made its name primarily as a dollar store. Last year, the firm announced it plans to maintain strong revenue growth by focusing on low-priced items. The company's decision to call attention to the products it sells for $1.25 and less — so the argument goes — will help keep sales high, while fending off competitors who generally carry higher-priced items.

Recent financial results

If Dollarama's latest financial results are any indication, the firm's strategy seems to be working. The company recorded sales growth of 9.5% year over year, while operating income, earnings before interest, taxes, depreciation, and amortization, and net income increased by 3.8%, 4.1%, and 6.5%, respectively. Perhaps more importantly, comparable store sales grew 5.8%, which was much better than the 2.6% figure recorded during the same period of the previous fiscal year.

Dollarama pointed to a 4.9% increase in average transaction size as the main factor behind its stellar comparable store sales growth. Further, the firm opened 66 stores during the period. It would be unwise to reach definitive conclusions about whether Dollarama's strategy will maintain its earnings growth at a high level for many years to come. Still, these results are encouraging.

Should you buy?

While Dollarama may seem a bit expensive, it isn't rare to have to pay a premium for a stock that has delivered market-beating returns. The company seems well on its way to at least get back to its early 2018 level, and with several more opportunities for growth abroad, the firm's stock could rise even higher. It might be worth considering purchasing shares of Dollarama today.

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