Will Latin America Solve Dollarama's (TSX:DOL) Growth Problems?

Description

Dollarama (TSX:DOL) announced on Tuesday that the company would be acquiring controlling interest in Dollar City for an estimated price between US$85 million and US$95 million. It's a big move for the company that's expected to close as soon as next month.

Does this make Dollarama a better buy today?

To assess this, we should look at two items: growth and profits. Dollarama is still a growth stock for many investors, and having more opportunities is going to be crucial in convincing investors that the stock is worth a premium. Profitability is also important given the state of the retail industry in North America and how fragile it has become.

The good news is that in Dollarama's earnings release, it stated it believes that for the remainder of the current fiscal year, the acquisition will add between $0.02 and $0.03 in per-share earnings. In the following fiscal year, that number is expected to rise to between $0.05 and $0.07. Ultimately, that's not much for a company that, over the past four quarters, has generated earnings per share of $1.69. Even a $0.07 improvement would be a modest 4% improvement off that figure.

The reality is that this deal is more about long-term growth than it is about adding some immediate bang to the bottom line. It's clear that with the stock recently struggling as a result of underperforming sales numbers, the focus has been on finding ways to improve its growth, and this is clearly one way to do so. In the press release, the company's CEO Neil Rossy stated that "Dollarama is establishing a compelling second growth platform, in complement to our Canadian growth strategy."

However, he's careful to point out that this wasn't a knee-jerk decision, and it took a lot of thought and analysis: "After six years of due diligence review and on-the-ground experience in Latin America, we believe that now is the right time to exercise our option to acquire this interest, and that Dollar City is the right vehicle to capture the growth potential we see in our chosen markets."

There's a lot of expansion planned for Dollar City, which hopes to reach 600 stores by 2029. It currently has 180 locations spread across three countries: El Salvador, Guatemala, and Colombia, which is the company's main focus at this point.

Whether or not you believe this makes Dollarama a better investment today comes down to how appealing these Latin American markets are for future growth. There are many opportunities there, especially in Colombia, which, at around 50 million people, is much bigger than Canada and gives Dollarama significant potential. While there are greater political risks in the country that can't be denied, it's clear that Dollarama has done its research into the area and likely determined that the opportunities far outweigh the risks and potential costs.

Bottom line

Dollarama was running out of room to grow in Canada, and without having to make a much bigger purchase to get into the U.S., expanding into Latin America was likely the next best option. It looks like a good move today that won't tie up a lot of money for the company, and that could result in the growth that investors are after.

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