Dollarama (TSX:DOL) Stock: A Great Company But Too Expensive

Description

There's no denying that **Dollarama** (TSX:DOL) is a great company. Over the past two decades, it has grown from a small regional chain to Canada's largest dollar store. Its stock has also been a winner, rising 1,600% in 11 years. That shouldn't surprise any Canadian investors. You only need to walk down any city street to see how ubiquitous the chain has become, when hardly anybody knew about it in 2000.

With all that said, as a stock, Dollarama's best days may be behind it. The company is still financially strong, but its growth potential is now limited. As you're about to see, Dollarama has few growth options remaining. So, its current stock price, which requires high growth to be justified, seems excessive.

Solid financial results

Dollarama has generated solid financial results in the current year. In the fourth quarter of fiscal 2020 — the first quarter of this *calendar* year — the company grew sales by 0.5%, same-store sales by 2%, and earnings by 7.5%. In the first quarter it grew sales by 2% but saw earnings decline 15% — mainly 0ecause of pandemic pay and other COVID-19 costs. In the second quarter, it grew sales by 7% and earnings by 2%.

All of the results above would have been much stronger had it not been for COVID-19 store closures. While Dollarama sells many essential items, certain stores were closed under public health quarters. However, its grocery items allowed it to remain open during the initial lockdowns in the spring.

Valuation getting steep

As shown above, Dollarama's recent results were pretty solid for a retailer in the COVID-19 era. The first quarter of fiscal 2020 was a loser, but that was mostly because of COVID-19 costs. It would have been much stronger in a normal economic period.

Nevertheless, Dollarama stock is getting very pricey. According to YCharts, the P/E ratio now sits at about 31. That's not insanely expensive, but it's the kind of P/E ratio you'd normally expect from a growth stock. And Dollarama isn't growing that quickly. If we took COVID-19 costs out of the equation, we could optimistically say that Dollarama would be growing earnings at 5-10% a year. That's the kind of growth we expect from bank stocks, and bank stocks normally don't have 30 P/E ratios.

So, it's hard to say why Dollarama is as expensive as it is. It seems like the stock might have gotten bid up this year, because investors wanted a recession-resistant stock for safety purposes. It delivered in that regard. But that would imply that the stock will decline once the vaccine is out and the "safety" thesis is no longer as compelling.

Foolish takeaway

Over the past decade, you'd have done well by holding Dollarama stock — extremely well. But now, the company is starting to look mature. It has already saturated the Canadian dollar store market by opening locations in every Canadian city. And its efforts at international expansion haven't borne fruit. So, while this is a great company, its greatness doesn't justify the current price.

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andrewbutton